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FOREIGN INCOME

Business Operations in the European Union — Taxation

by

Pascal Faes
Of Counsel Antaxius
Belgium

Pascal Faes, J.D., University of Ghent (1984); Special Degree in Economics, University of Brussels (VUB) (1987); Master in Tax Law, University of Brussels (ULB) (1991).

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TAX MANAGEMENT PORTFOLIOS™

FOREIGN INCOME

Business Operations in the European Union — Taxation

PORTFOLIO DESCRIPTION

Tax Management Portfolio, *Business Operations in the European Union — Taxation*, No. 7450-3rd, gives an overview of the development of EU law in the direct and indirect tax areas. Progress in the indirect tax area (customs duties, excise duties, value-added tax) has been relatively successful.

While the harmonization or approximation of Member States' legislation in the direct tax field has proven to be a cumbersome and slow-evolving process, a relatively wide array of new legislative initiatives have seen the light in recent years. In addition, the case law of the Court of Justice of the European Union has, over time, evolved into a substantial source of "negative integration." Analysis of the case law of the CJEU is therefore a common thread running through the Portfolio.

The Worksheets set out website links directing readers to content with particular relevance to EU taxation matters.

This Portfolio may be cited as Faes, 7450-3rd T.M., *Business Operations in the European Union — Taxation*.

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DETAILED ANALYSIS

I. Introduction and Portfolio Overview

A. The Role of the European Union in Tax

1. Background

The subject matter of this Portfolio, “EU tax law,” is a paradox in and of itself: as things currently stand, the European Union (also referred to as “the Union,” the “EU,” the “European Community” or “the Community”), as such, has no fiscal competence. Neither of the founding treaties (i.e., the Treaty of the European Union (TEU) and the Treaty on the Functioning of the European Union (TFEU)) envisages the creation of an EU tax common to the Member States and destined to finance the EU budget. It should be noted that the European Economic Community (EEC), the predecessor organization to the European Union, was established by the Treaty of Rome in 1957. This Treaty has since been amended and supplemented by a series of Treaties, the latest of which is the Treaty of Lisbon. The Treaty of Lisbon, which entered into force on December 1, 2009, reorganized the two Treaties on which the European Union is founded, i.e., the TEU and the Treaty Establishing the European Community (TEC), later renamed as the TFEU. The current, consolidated versions of the TEU and the TFEU were published in the *Official Journal* (OJ C 83) of March 30, 2010.

Article 3 of the TFEU defines the areas in which the Union has exclusive competence and those in which national governments of the Member States of the European Union are prohibited from acting. These areas are:

- (i) The customs union;
- (ii) The establishment of the competition rules necessary for the functioning of the internal market;
- (iii) The monetary policy for the Member States whose currency is the euro;
- (iv) The conservation of marine biological resources under the common fisheries policy; and
- (v) The common commercial policy.

Under the same provision, the Union also has exclusive competence for the conclusion of an international agreement when the conclusion of such an agreement:

- (i) Is provided for in a legislative act of the Union;
- (ii) Is necessary to enable the Union to exercise its internal competence; or
- (iii) May affect common rules or alter their scope.

Pursuant to Article 311 of the TFEU, “the Union shall provide itself with the means necessary to attain its objectives and carry through its policies.” The budget for those needs “shall be financed wholly from own resources.” This “system of own resources,”¹ currently under review, is designed to ensure that the

EU is able to finance its policies. Legally, these resources belong to the Union. However, it is the Member States that levy and collect such charges on behalf of the European Union and transfer them to the EU budget.

In other words, the founding treaties do not confer any fiscal competence or taxing power upon the European Union, nor do they provide for any EU tax or EU tax authority imposing taxes directly on EU nationals or citizens.

There is no EU tax as such and the European Union lacks any (exclusive) fiscal competence or taxing power. It follows that the concept of “EU tax law” pertains to the achievement of the internal market, the ultimate goal of the TEU and the TFEU, which necessarily requires the elimination of all tax obstacles resulting from the exercise by Member States of their tax sovereignty. This concept was formulated by the Court of Justice of the European Union (CJEU) in its *dictum* (which over the years has become something of a *mantra*) to the effect that, although direct taxation does not as such fall within the purview of the European Union, the powers retained by the Member States must nonetheless be exercised consistently with EU law.² In that sense, pending the possible future adoption of an EU tax, the concept of “EU tax law” determines the conditions under which the EU authorities and the Member States eliminate the fiscal obstacles that persist within the internal market, arising in the context of both EU primary legislation and EU secondary legislation.

2. Hierarchy of EU Law

The Treaties, i.e., the TEU and the TFEU, form the primary legislation of the European Union. EU secondary legislation is made by the EU institutions and takes the form of one of the five EU legal instruments specifically provided for in the Treaties, i.e., Regulations, Directives, Decisions, Recommendations and Opinions. As set out in TFEU, Article 288:

- (i) A Regulation has general application and is binding in its entirety and directly applicable in all Member States;
- (ii) A Directive is binding, as to the result to be achieved, upon each Member State to which it is addressed, but leaves to the national authorities the choice of form and methods;
- (iii) A Decision is binding in its entirety (a Decision specifying those to which it is addressed is binding only on those addressed);

²Case C-279/93, *Schumacker*. Compare with the landmark decision, outside the tax context, in Case 6/64, *Costa v. ENEL*: “[T]he law stemming from the Treaty, an independent source of law, could not, because of its special and original nature, be overridden by domestic legal provisions, however framed, without being deprived of its character as Community law and without the legal basis of the Community itself being called into question. The transfer by the States from their domestic legal system to the Community legal system of the rights and obligations arising under the Treaty carries with it a permanent limitation of their sovereign rights, against which a subsequent unilateral act incompatible with the concept of the Community cannot prevail.”

¹See Worksheet 1 — The System of “Own Resources”.

(iv) A Recommendation calls upon the party to which it is addressed to behave in a particular way without however placing it under any legal obligation; and

(v) An Opinion issued by the EU institutions gives assessments of situations or developments in the Union or in the individual Member States. Opinions may also prepare the way for subsequent, legally binding acts, or be a prerequisite for the institution of proceedings before the CJEU. Recommendations and Opinions have moral and political significance, without being legally binding.

The three other main forms of actions that shape the EU legal order without having legally binding effect are Resolutions, Declarations and Action programs.

3. Primary Legislation on Tax Policy

The TFEU contains two specific categories of tax provisions:

- (i) Provisions dealing with customs duties and charges having equivalent effect (see, XIV.); and
- (ii) Provisions targeted against discriminatory or protective internal taxation (see XIX.).

In addition, the TFEU encompasses a number of provisions that are general in nature and scope and, hence, not specifically related to (Member States') taxation but that, in their interpretation — as it has evolved over time in response to the influence of CJEU case law — nonetheless affect and impact the tax sphere.

These provisions concern, in particular:

- (i) The TFEU fundamental freedoms (i.e., the free movement of goods, the free movement of persons (the free movement of workers and the freedom of establishment), the freedom to provide services and the free movement of capital and payments) (see II.); and
- (ii) The State aid rules (see XVI.), which have seen a true “renaissance” in the field of tax as a result of the Commission's (ongoing) investigations, (pending) Commission decisions, and the CJEU's jurisprudence with respect to (transfer pricing) tax rulings issued by Member States involving multinational enterprises (see XVI.C.).

As will also be illustrated below, over the years, the transposition by the CJEU of the fundamental freedoms in the (direct) tax area has become increasingly important, thus significantly contributing to the phenomenon of “negative harmonization.”

4. Secondary Legislation on Tax Policy

As regards secondary legislation, most progress has been achieved in the harmonization or approximation of indirect taxes,³ more specifically:

- (i) Customs duties (see XIX.);
- (ii) Value added tax (VAT — see XVII.);
- (iii) Excise duties (see XVIII.); and
- (iv) Taxes on the raising of capital (see XIV.).

The harmonization or approximation of Member States' legislation in the direct tax area has proven to be a far more cumbersome and time-consuming process with, admittedly, rather limited success to date. The (principal) reason is, no doubt, the unanimous vote requirement contained in Article 115 of the TFEU.

Under Article 114(1), TFEU, the European Parliament and the Council, acting in accordance with the ordinary legislative procedure and after consulting the Economic and Social Committee, are empowered to adopt measures for the approximation of the provisions laid down by law, regulation or administrative action in Member States that have as their object the establishment and functioning of the internal market. However, this rule of “qualified majority voting” is *not* applicable to *fiscal* provisions, to provisions relating to the free movement of persons or to provisions relating to the rights and interests of employed persons (Article 114(2), TFEU).

Hence, as far as harmonization or approximation in the direct tax area is concerned, the (only) fallback provision is Article 115 under which the Council, acting unanimously in accordance with a special legislative procedure and after consulting the European Parliament and the Economic and Social Committee, can issue directives for the approximation of such laws, regulations or administrative provisions of the Member States as directly affect the establishment or functioning of the internal market. Thus, Article 115, unlike Article 114, requires a unanimous vote.

Nevertheless, various tax harmonization measures have been successfully implemented in relation to, among other matters:

- (i) EU cross-border mergers and restructurings (the Merger Tax Directive — see III.);
- (ii) EU cross-border dividend payments (the Parent-Subsidiary Tax Directive — see IV.);
- (iii) EU cross-border interest and royalty payments (the Interest and Royalty Directive — see V.);
- (iv) European corporate vehicles (the European Economic Interest Grouping (EEIG), the European Company, the European Cooperative Society and the European Private Company — see XIII.);
- (v) EU transfer pricing (the Arbitration Convention — see XII.);
- (vi) Tax avoidance (the Anti-Tax Avoidance Directives (ATAD 1 and ATAD 2 (hybrid mismatches)) — see VI.);
- (vii) Pillar Two (see VII.), and
- (viii) FASTER (see VIII.).

Secondary legislation recently proposed by the Commission concerns primarily increasing the harmonization or approximation of Member States' laws in the direct tax law area. The draft directives currently under discussion include the following:

³TFEU, Art. 113 specifically provides for the Council, acting unanimously in accordance with a special legislative procedure and after consulting the European Parliament and the Economic and Social Committee, to adopt provisions for the harmonization of legislation concerning turnover taxes, excise duties and other forms of indirect taxation to the extent such harmonization is necessary to ensure the establishment and functioning of the internal market, and to avoid distortion of competition.

(i) The BEFIT Proposal (see X.); and

(ii) The Head Office Tax System Proposal (see XI.).

Other recent EU tax developments include the following:

(i) The (ever-evolving) Directive on administrative cooperation in the field of direct taxation (DAC) and its, to date, nine revisions or amendments (see XXI.);

(ii) The Carbon Border Adjustment Mechanism (CBAM) Regulation (see XX.);

(iii) The Code of Conduct for Business Taxation (see XV.);

(iv) The ongoing work on the list of “non-cooperative jurisdictions;” (see XXII.) and

(v) The gradual development of an EU anti-abuse doctrine (see XXIII.).

Aborted or “dormant” legislative initiatives of the Commission include:

(i) The proposal for a Common (Consolidated) Corporate Tax Base;

(ii) The proposals for fair taxation of digital presence and services;

(iii) The proposal for a financial transaction tax;

(iv) The proposal for laying down rules on a debt-equity bias reduction allowance and limiting the deductibility of interest for corporate income tax purposes (DEBRA); and

(v) The transfer pricing proposal.

Due to their significant precedential value, these initiatives are summarized in IX., below.

5. Judicial Branch

Since the establishment of the CJEU in 1952, the Court’s mission has been to ensure that EU law is observed in the interpretation and application of the Treaties. As part of that mission, the CJEU:

(i) Reviews the legality of the acts of the institutions of the European Union;

(ii) Ensures that the Member States comply with their obligations under the Treaties; and

(iii) Interprets EU law at the request of the national courts and tribunals.

The CJEU thus constitutes the judicial authority of the European Union and, in cooperation with the courts and tribunals of the Member States, ensures the uniform application and interpretation of EU law.

The CJEU, which has its seat in Luxembourg, consists of three courts: the Court of Justice, the General Court (created in 1988) and the Civil Service Tribunal (created in 2004). Since their establishment, the three courts have delivered close to 30,000 judgments. For purposes of this Portfolio, the “Court of Justice” (previously also known as the “ECJ”) is hereinafter referred as the CJEU (or the “Court”).

Regulation (EU, Euratom) 2024/2019 of the European Parliament and of the Council of April 11, 2024 amending Protocol No. 3 on the Statute of the Court of Justice of the European Union introduced a major reform to the judicial architecture of the EU, specifically by transferring partial jurisdiction for preliminary rulings from the CJEU to the General Court with a view to reducing the workload of the CJEU. This reform became operational on October 1, 2024. Under the reform, the General Court has henceforth jurisdiction to hear and determine requests for a preliminary ruling that fall exclusively within one or several of the following specific areas:

(i) The common system of value added tax;

(ii) Excise duties;

(iii) The Customs Code;

(iv) The tariff classification of goods under the Combined Nomenclature;

(v) Compensation and assistance to passengers in the event of denied boarding or of delay or cancellation of transport services; and

(vi) The system for greenhouse gas emission allowance trading.

The CJEU retains jurisdiction to hear and determine requests for a preliminary ruling raising independent questions of interpretation of primary law, public international law, general principles of EU law or the Charter of Fundamental Rights of the European Union.

B. Portfolio Organization

The sequence of chapters is as follows:

(i) Chapters II – XV address (primarily) issues in the realm of business taxation;

(ii) Chapter XVI is dedicated to state aid;

(iii) Chapters XVII – XIX deal with indirect taxes (custom duties, charges having equivalent effect, internal taxation and VAT);

(iv) Chapter XX gives an overview of the carbon border adjustment mechanism (which blends features of both tax and custom duties);

(v) Chapters XXI (DAC) and XXII (Non-Cooperative Jurisdictions) address administrative cooperation within the EU;

(vi) Building on Chapters II – XIX, the final Chapter XXI-II presents a synthesis of the EU anti-abuse doctrine, a notion developed primarily through CJEU case law but also reflected in secondary (tax) legislation.

The Portfolio examines the relevant legislation and offers a concise synthesis of the evolution of CJEU case law in recognition of the fact that the jurisprudence of the Court serves, in relation to both EU primary and EU secondary legislation, as a supplementary source of law.

II. The TFEU Fundamental Freedoms and Direct Taxation

A. General

Executive Summary

This Section provides an overview of how and to what extent the fundamental freedoms enshrined in the TFEU (i.e., the free movement of persons, the freedom to provide services, the free movement of capital and the free movement of goods) impact national measures adopted by the Member States in the direct tax area, a process that has largely been, and continues to be, driven by the CJEU.

The crux of that process is the concept of (the prohibition on) “discrimination” (deemed to cover both “open” and “covert” discrimination). This concept allows the Member States a certain margin where it can reasonably be demonstrated that a national tax measure pursues one or more (acceptable) purposes, the grounds for which can be justified, subject always to the meeting of a proportionality test (see II.A. through II.D., below).

After discussing the scope of the fundamental freedoms and the ways in which they affect the direct tax area, taking account of the role of the (evolving) grounds for justification and the proportionality test, the Section proceeds with an overview of the case law of the CJEU, taking a topical approach that addresses each fundamental freedom in turn (see II.E., below).

The Section then analyses the relationship between the TFEU fundamental freedoms and (bilateral) tax treaties, focusing on aspects such as the primacy of EU law, EU law compatibility issues, most favored nation (MFN) treatment, limitation on benefits (LOB) clauses, and the elimination or mitigation of juridical double taxation (see II.F., below).

The Section closes with a discussion of the interaction between the TFEU fundamental freedoms and the harmonization of secondary tax legislation (with a particular emphasis on the specific case of the Pillar Two Directive) (see II.G., below).

The TFEU does not contain any provisions that explicitly or otherwise exclusively concern direct taxes,⁴ unlike in the case of indirect taxes, which are expressly addressed in the TFEU by way of both:

- (i) A legislative empowerment provision;⁵ and

⁴As far as empowerment is concerned, TFEU, Art. 114 expressly excludes fiscal provisions from its scope of application. Harmonization in the field of direct taxation is therefore based on the — general — provision in TFEU, Art. 115 under which, without prejudice to Art. 114, the Council, acting unanimously in accordance with a special legislative procedure and after consulting the European Parliament and the Economic and Social Committee, is to issue directives for the approximation of such laws, regulations or administrative provisions of the Member States as directly affect the establishment or functioning of the internal market (see VIII., below).

- (ii) Directly applicable tax prohibitions aimed at ensuring the free movement of goods within the European Union and the effectiveness of the Customs Union.⁶

However, as a result of the impact of the decisions of the CJEU, direct tax provisions of the Member States are considered to fall within the ambit of the “fundamental freedoms” conferred on EU citizens by the TFEU, i.e.:

- (i) The free movement of persons;
- (ii) The freedom to provide services;
- (iii) The free movement of capital; and
- (iv) The free movement of goods (less relevant to the direct tax area).⁷

Since the seminal ruling in *Schumacker*,⁸ it is settled case law that although, as EU law currently stands, direct taxation does not as such fall within the purview of the European Union, the powers retained by the Member States must nonetheless be exercised consistently with EU law.

In other words, national direct tax provisions (including international tax conventions) of the Member States must not compromise the freedoms enshrined in the TFEU.

The free movement of goods is structured along a two-pronged approach, i.e.:

- (i) The establishment of a customs union (Article 28 of the TFEU), involving:

- The prohibition between Member States of customs duties on imports and exports and all charges having equivalent effect (Article 30 of the TFEU);
- The adoption of a common customs tariff that may apply to goods coming into the European Union from third countries; and
- The elimination of discriminatory and protectionist taxation (Article 110 of the TFEU) (see XIX., below); and

- (ii) The removal of quantitative restrictions on trade and all measures having equivalent effect, covering both:

⁵See Article 113 of the TFEU and Footnote 6, above.

⁶I.e., Article 30 of the TFEU, which prohibits customs duties and charges having equivalent effect and Article 110 of the TFEU, which prohibits discriminatory and protective internal taxation.

⁷See TFEU, Art. 26(2), which stipulates that the internal market is to comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of the Treaties. The Maastricht Treaty of 1992 extended the right of free movement to EU citizens (TFEU, Art. 2), i.e., to those holding the nationality of a Member State. At first it was not clear whether this provision merely codified the rights in TFEU, Arts. 45, 49 and 56 or whether it extended the right to free movement to those who are not economically active. CJEU case law appears to suggest the latter.

⁸Case C-279/93, *Schumacker*. Compare with the landmark decision, outside the tax context, in Case 6/64, *Costa v. ENEL*: “[T]he law stemming from the Treaty, an independent source of law, could not, because of its special and original nature, be overridden by domestic legal provisions, however framed, without being deprived of its character as Community law and without the legal basis of the Community itself being called into question. The transfer by the States from their domestic legal system to the Community legal system of the rights and obligations arising under the Treaty carries with it a permanent limitation of their sovereign rights, against which a subsequent unilateral act incompatible with the concept of the Community cannot prevail.”

- Imports (Article 34 of the TFEU); and
- Exports (Article 35 of the TFEU).

The free movement of persons covers:

- The freedom of movement of workers (Articles 45–48 of the TFEU); and
- The right of establishment (Articles 49–55 of the TFEU).

The free movement of workers entails the abolition of any discrimination based on nationality between workers of the Member States as regards:

- Employment;
- Remuneration; and
- Other conditions of work and employment.⁹

The right of establishment prohibits restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State.

This prohibition also applies to restrictions on the setting-up of:

- Agencies;
- Branches; or
- Subsidiaries

by nationals of any Member State established in the territory of any Member State.

The right of establishment includes:

- The right to take up and pursue activities as a self-employed person;
- The right to set up and manage undertakings, in particular:
 - Companies or firms constituted under civil or commercial law (including cooperative societies); and
 - Other legal persons governed by public or private law, save for those that are nonprofit-making.

The situation of shareholders must be appreciated from the perspective of the freedom of establishment (rather than from that of the free movement of capital) where their holdings give them definite influence over the company's decisions and allows them to determine its activities.¹⁰

However, a Member State's national rules relating to the tax treatment of dividends from a third country that do not apply exclusively to situations in which the parent company exercises decisive influence over the company paying the dividends must be assessed in light of the Treaty provisions on the free movement of capital (see below).¹¹

⁹ See also Regulation (EEC) No. 1612/18 of October 15, 1968 on the freedom of movement for workers within the Community, which requires that equality of treatment of workers be ensured in fact and in law (fifth recital of preamble) and, more specifically, that workers who are nationals of a Member State enjoy, in the territory of another Member State, the same tax advantages as national workers (Art. 7(2)) and Council Regulation 492/2011/EU on Freedom of Movement for Workers within the Union, 2011).

¹⁰ Case C-436/00, *X and Y*; Case C-251/98, *Baars*. Third-country nationals cannot indirectly benefit from the freedom of establishment through their rights under the free movement of capital.

¹¹ Case C-35/11, *Test Claimants in the FII Group Litigation*.

The freedom to provide services (Articles 56–62 of the TFEU) prohibits restrictions with respect to nationals of Member States who are established in a Member State other than that of the person for whom the services are intended.¹²

The person providing a service may, in order to provide the service, temporarily¹³ pursue his or her activity in the Member State where the service is being provided, under the same conditions as those imposed by that State on its own nationals.

The freedom to provide services:

- Grants the provider of a service the right to enter the market of another Member State and to be treated there in the same way as a domestic service provider; and
- Protects the recipient of that service.

The freedom to provide services is “residual” in that it only applies insofar as the services at issue are not governed by the provisions relating to the freedom of movement of goods, capital or persons.¹⁴

The concept of “services” within the meaning of Article 56 of the TFEU implies that:

- Services are ordinarily provided for remuneration; and
- The remuneration constitutes consideration for the service in question and is agreed upon between the provider and the recipient of the service.¹⁵

Thus, the decisive factor that brings an activity within the ambit of the Treaty provisions on the freedom to provide services is its economic character, i.e., the activity must not be provided for nothing.

However, it is not necessary for the person providing the service to be seeking to make a profit.¹⁶

“Services” include, in particular:

- Activities of an industrial or commercial character;
- Activities of craftsmen; and
- Activities of the professions.

The free movement of capital (and payments) (Articles 63–66 of the TFEU) prohibits all restrictions on the movement of capital (and payments) between Member States and between Member States and third countries.¹⁷

¹² Services that the provider renders without moving from the Member State in which he/she is established for recipients established in other Member States constitute the provision of cross-border services for purposes of TFEU, Art. 56 (see, *inter alia*, Case C-384/93, *Alpine Investments* and Case C-243/01, *Gambelli and Others*). Thus, the Treaty rules on the freedom to provide services cannot be applied to cases that have no factor linking them with any of the situations governed by Community law and all elements of which are purely internal to a single Member State (Joined Cases C-64/90 and C-65/96, *Land Nordrhein-Westfalen v. Uecker and Jacquet v. Land Nordrhein-Westfalen*; Case C-134/95, *USSL N° 47 di Biella v. INAIL* and Case C-332/90, *Steen v. Deutsche Bundespost*).

¹³ The temporary nature of the provision of services is to be determined in light of its duration, regularity, periodicity and continuity (Case C-55/94, *Gebhard*).

¹⁴ Case C-159/90, *Grogan*. See also Case 205/84, *Commission v. Germany* and Joined Cases 286/82 and 26/83, *Luisi & Carbone*.

¹⁵ See Case 263/86, *Humbel and Edel*; Case C-109/92, *Wirth*; and Case C-355/00, *Freskot*.

¹⁶ See, *inter alia*, Case C-157/99, *Smits and Peerbooms* and Case C-281/06, *Jundt*.

¹⁷ The objective of extending the free movement of capital beyond the European Union was, apparently, to support the euro as an international reserve

It applies in situations where:

- (i) A person neither pursues an economic activity nor has a permanent presence in the State in which the (tax) measure under challenge was enacted;¹⁸ or
- (ii) A shareholder has an insufficient level of participation in a company to benefit from the freedom of establishment rules.¹⁹

It is settled case law of the CJEU that third-country nationals cannot indirectly benefit from the freedom of establishment (which is not open to them) through their rights under the free movement of capital. According to the Court, in cases where the national rules involved fall within the material scope of the freedom of establishment rather than the free movement of capital, any restrictive effects on the latter freedom are merely an “unavoidable consequence” of the restriction on the former freedom.²⁰

However, a Member State’s national rules relating to the tax treatment of dividends from a third country that do not apply exclusively to situations in which the parent company exercises decisive influence over the company paying the dividends must be assessed in the light of the Treaty provisions on the free movement of capital.²¹

currency. The extension of the benefits and rights under the free movement of capital to residents and citizens of countries that are not party to the EC Treaty applies without reciprocity being required from these non-Member States. See on the scope of this extension: Joined Cases C-163/94, C-165/94 and C-250/94, *Sanz de Lera* and, with respect to direct taxation, Case C-101/05, *Skatteverket v. A*.

¹⁸ Case C-451/05, *ELISA*.

¹⁹ Case C-436/00, *X and Y*.

²⁰ See Case C-342/00, *Lankhorst-Hohorst*; Case C-196/04, *Cadbury Schweppes*; Joined Cases C-282/04 and C-283/04, *Commission v. Netherlands* (Golden Share); Case C-294/04, *Lasertec*; C-452/04, *Fidium Finanz*; Case C-524/04, *Thin Cap GLO. Adde*, Case C-47/12, *Kronos International*; Case C-190/12, *Emerging Markets Series of DFA Investment Trust Company*; and Case C-464/15, *SECIL*: “(...) since the [TFEU] does not extend freedom of establishment to non-member States, it is important to ensure that the interpretation of Article 63(1) TFEU as regards relations with those states does not enable economic operators who do not fall within the territorial scope of freedom of establishment to profit from that freedom.” Not unsurprisingly, it has been suggested that, in holding that the freedom of establishment prevails over the free movement of capital, the CJEU is intentionally attempting to curb non-member countries’ rights under the free movement of capital.

²¹ See, e.g., Case C-464/14, *SECIL* concerning Portugal’s tax treatment of dividends from third-country subsidiaries. *SECIL*, a Portuguese company, had major shareholdings in companies resident in Lebanon and Tunisia (direct holdings of 28.64% and 98.72%, respectively). The dividends that *SECIL* received from those subsidiaries were fully taxed in Portugal. The question arose whether, given the full or partial deduction available for domestic dividends, such taxation violated either the Treaty provisions on the free movement of capital (TFEU, Arts. 63 to 65) or the Euro-Mediterranean Agreements with Lebanon and Tunisia, respectively. Both agreements were concluded by the European Communities and their Member States (including Portugal), and contain provisions on establishment and capital movement but also certain tax carve-outs (Arts. 31, 33 and 85 and Arts. 31, 34 and 89, respectively). As the Portuguese legislation at issue was not intended to apply exclusively to situations in which the recipient company had a decisive influence over the distributing company, the CJEU considered Art. 63 to be applicable and found the Portuguese rules to amount to a restriction on free movement of capital, as they overtly distinguished between domestic dividends (full or partial deductibility) and comparable third-country dividends (full taxation). In the Court’s words, TFEU, Art. 63 requires a Member State that has a system for preventing economic double taxation as regards dividends paid to residents by other resident companies to accord equivalent treatment to dividends paid to residents by nonresident companies.

A company resident in a Member State may therefore rely on those provisions to call into question the legality of such rules, irrespective of the size of its shareholding in a company paying dividends established in a third country.²²

On the other hand, the prohibition laid down in Article 63 of the TFEU is not “absolute” as it is without prejudice to:

- (i) The right of Member States to:

- (a) Apply the relevant provisions of their tax law that distinguish between taxpayers who are not in the same situation with regard to their place of residence or with regard to the place where their capital is invested; and

- (b) Take all requisite measures to prevent infringements of national law and regulations, in particular in the field of taxation and the prudential supervision of financial institutions, or lay down procedures for the declaration of capital movements for purposes of administrative or statistical information, or take measures that are justified on public policy or public security grounds; and

- (ii) The applicability of restrictions on the right of establishment that are compatible with the TFEU (and the Treaty of the European Union (TEU)) (provided such measures and procedures do not constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital and payments as defined in Article 63).²³

In 2011, the CJEU decided in *Prunus*²⁴ that Article 63 of the TFEU also applied to the British, Danish, Dutch and French Overseas Countries and Territories (OCTs), which were not part of the internal market but were associated with the European Union, as if they were third countries (they were not third countries, since they were part of the EU Member States; for example, the Caribbean island of Curaçao was part of the Kingdom of the Netherlands, both constitutionally and under public international law; under EU law, Curaçao was an OCT).

Three years later, however, the CJEU decided otherwise in *X BV and TBG Limited*,²⁵ where it held that Article 63 did not apply to the OCTs, but that, instead, a special capital movement provision contained in the OCT Association Decision applied in relation to the OCTs.²⁶

It is (now) settled case law of the CJEU that the fundamental freedoms have (vertical) direct effect, meaning that they establish not only obligations for Member States, but also rights for individuals. Individuals may therefore take advantage

²² Case C-35/11, *Test Claimants in the FII Group Litigation*.

²³ TFEU, Art. 65 (see, e.g., Case C-47/12, *Kronos*). In addition, pursuant to TFEU, Art. 66, where, in exceptional circumstances, movements of capital to or from third countries cause, or threaten to cause, serious difficulties for the operation of economic and monetary union, the Council, on a proposal from the Commission and after consulting the European Central Bank, may take safeguard measures with regard to third countries for a period not exceeding six months if such measures are strictly necessary.

²⁴ Case C-384/09, *Prunus*.

²⁵ Joined Cases C-24/12 and C-27/12, *X BV and TBG Limited*.

²⁶ The special capital movement provision contained in the OCT Association Decision provides less freedom, since it applies only to “direct investments in companies,” whereas TFEU, Art. 63 also applies to (at least) 12 other categories of capital movements, such as investments in immovable property.

of these freedoms and directly invoke them against Member States²⁷ before national and European courts.²⁸

Much more controversial is the question of whether these Treaty provisions also apply horizontally, i.e., whether they can be invoked against other non-State (i.e., private party) actors.²⁹

Breach of fundamental freedoms may result in Member State liability.³⁰

B. Testing Direct Tax Measures Against Fundamental Freedoms — Concepts and Methodology

In all tax cases brought before it, the CJEU will perform a discrimination and/or restriction analysis to determine whether the national tax rule under scrutiny is in breach of EU law.

The following rules are prohibited:

- (i) Rules that differentiate based on nationality (direct or overt discrimination) that amount to discrimination;
- (ii) Rules that apply other differentiating criteria but in fact lead to the same result as a directly discriminatory rule (indirect or covert discrimination).

This is particularly relevant in matters of direct taxation where distinctions are rarely made based on nationality but are (more) often made based on residence.³¹

Moreover, the CJEU prohibits not only discriminatory measures but also equally applicable restrictive measures because they:

- Hinder intra-EU trade; and
- Make the exercise of the Treaty freedoms less attractive.³²

To this end, “restrictive” measures means “all trading rules enacted by Member States which are capable of hindering, directly or indirectly, actually or potentially, intra-EU trade.”

Hence, a national (tax) rule may be incompatible with EU law if it:

- Creates an indirect hindrance to the exercise of the free movement rights; or
- Has potential restrictive effects, even though the restriction has not yet taken place.³³

While discrimination occurs when different treatment is applied overtly or covertly to two categories of taxpayers, national rules may apply on a basis that does not as such distinguish between (resident and nonresident) taxpayers but still have restrictive effects on intra-EU trade.

In fact, national rules applied unevenly between two categories of taxpayers may be discriminatory and restrictive in terms of the Treaty.

For example, in *Avoir Fiscal*,³⁴ in which the CJEU performed:

- A discrimination analysis; and
- A restriction analysis

of a national tax measure, the discriminatory French tax rule was found to restrict a nonresident company’s right to exercise a freedom guaranteed by the EC Treaty.

Even a minimum obstacle or a minor difference in tax treatment between an internal and a cross-border transaction could amount to prohibited discrimination.

In other words, a national tax rule could be held to be incompatible with EU law even if the restriction caused by the rule was of limited scope or minor importance.³⁵

Notwithstanding the foregoing, it would be an overstatement to claim that the CJEU has abandoned its discrimination analysis in favor of a restriction-based reading of the fundamental freedoms.

In determining the existence of an obstacle to free movement, the CJEU continues to focus on the existence of a difference in treatment between domestic and cross-border situations.

On the other hand, many of the cases that are generally perceived as involving the application of a restrictive-based reading of the fundamental freedoms amount to genuine discrimination cases.

Arguably, therefore, both approaches are complementary components of the fundamental freedoms.

²⁷ For this purpose, the concept of “State” includes organizations or bodies that are subject to the authority or control of the State or have special powers beyond those resulting from the normal rules applicable to relations between individuals. The Court has accordingly held that provisions that have (vertical) direct effect can be relied on against tax authorities (see, e.g., Case 8/81, *Becker* and Case C-221/88, *ECSC v. Acciaierie e Ferriere Bussent (in liquidation)*).

²⁸ See, e.g., Case 74/76, *Meroni* and Case 58/80, *Dansk Supermarked A/S v. Imerco* (free movement of goods); Case 41/74, *van Duyn* (free movement of workers); Case 2/74, *Reyners* (freedom of establishment); Case 33/74, *van Binsbergen* (freedom to provide services); Case C-484/93, *Svensson and Gustavsson* (free movement of capital). These cases build on the seminal case that accepted the direct effect of (main, substantive) Treaty articles, i.e., Case 26/62, *van Gend and Loos*.

²⁹ Based on CJEU case law, the view that can most confidently be put forward is that TFEU, Arts. 34 and 35 (free movement of goods) have vertical direct effect only (except in the area of intellectual property), whereas TFEU, Art. 45 (free movement of workers) is considered to have both vertical and horizontal direct effect (Case C-281/98, *Angonese*). The position seems to be less clear with respect to TFEU, Art. 49 (freedom of establishment) and TFEU, Art. 56 (freedom to provide services). From *Viking* (Case C-438/05 *International Transport Workers’ Federation v. Viking Line*), it could well be inferred that these provisions do have both vertical and horizontal direct effect. However, the defendant in that case was a trade union with powers analogous to those of a state body, so the case may actually involve some extended form of vertical direct effect. As regards TFEU, Art. 63 (free movement of capital), CJEU case law so far has concerned vertical direct effect only.

³⁰ Joined Cases C-46 and C-48/93, *Brasserie du Pêcheur SA v. Federal Republic of Germany and R. v. Secretary of State for Transport, ex parte Factortame and others (Factortame III)*.

³¹ See, e.g., Case C-175/88, *Biehl*, in which the CJEU held that even though the criterion of permanent residence in the national territory applies irrespective of the nationality of the taxpayer concerned, there is a risk that it will work in particular against taxpayers who are nationals of other Member States; in the case of companies, see, e.g., Case C-330/91, *Commerzbank*, in which the CJEU emphasized that the rules regarding equality of treatment forbid not only overt discrimination by reason of nationality or, in the case of a company, its seat, but all covert forms of discrimination that, by the application of other differentiation criteria (in the case at hand, fiscal residence), lead in fact to the same result.

³² It should be noted, however, that many of the cases that are generally perceived as representing the application of a restrictive-based reading of the fundamental freedoms amount in fact to genuine discrimination cases. Indeed, in determining the existence of an obstacle to free movement, the CJEU has consistently focused on the existence of a difference in treatment between domestic and cross-border situations.

³³ Case 8/74, *Procureur du Roi v. Dassonville*.

³⁴ Case 270/83, *Avoir Fiscal*.

³⁵ Case C-9/02, *Hughes de Lasteyrie du Saillant*.

Accordingly, where a national tax measure applies without any distinction based on a prohibited criterion, the concept of nondiscrimination is insufficient.

In such cases, the situation can be remedied by having recourse to the restriction component of the fundamental freedom at issue.

The CJEU's approach towards testing a national tax measure on its compatibility with the fundamental freedoms involves a two-stage process, with the second stage involving a further three-step analysis.

(i) First, the CJEU examines whether the fundamental freedoms are applicable to the situation at issue. There are two angles to this examination:

- For the freedoms to apply, there must (in principle) be an EU cross-border element. Hence, situations that are confined in all respects within a single Member State, and thus purely internal to that Member State, do not as such come within the scope of application of the freedoms.³⁶
- In other words, situations that remain wholly internal to one Member State are not covered by the freedoms. A “cross-border element” to the case is required.
- Nevertheless, since the 1990s, the CJEU has made exceptions to this rule. The Court held that it had jurisdiction to give preliminary rulings on questions concerning provisions of EU law in situations where the facts of the case pending before the national court were outside the scope of that law. This was, however, conditional on EU law having been rendered applicable either by domestic law or merely by virtue of terms in a contract.³⁷
- On the other hand, the traditional view (subject to certain isolated exceptions)³⁸ of the CJEU is that reverse discrimination is not precluded by the freedoms, i.e., a Member State is not prohibited from treating its own nationals less favorably than nationals from other Member States in so far as there is no cross-border element.³⁹
- Nonetheless, in certain specific circumstances where a Member State discriminates against its own nationals, the CJEU may bring these persons within the scope of the Treaty by equating them with nationals of other Member States.

This may be the case when a national of a Member State who has resided on the territory of another Mem-

ber State wishes to exercise his/her Treaty freedoms to return to his/her State of origin.

Although the Treaty freedoms cannot be applied to purely internal situations, they nevertheless cannot be interpreted in such a way as to exclude a Member State's own nationals from the benefit of EU law where by reason of their conduct they are, with regard to their Member State of origin, in a situation that is equivalent to that of any other person enjoying the rights and liberties guaranteed by the Treaty.⁴⁰

(ii) Second, once it is established that the fundamental freedoms are applicable, the methodology of the CJEU involves a further three-step analysis.

The key questions in that analysis are:

(i) Are the persons being compared in a comparable situation? To establish whether this is the case, the CJEU verifies whether the characteristics relevant to the measure at issue are identical — if they are not, the situations are not comparable.

(ii) Has there been a difference in treatment between the situations at issue?

- If there is no difference in treatment and the situations are comparable, there is no discrimination (the concept of “discrimination” encompassing both direct/overt discrimination and indirect/covert discrimination).⁴¹
- If there is no difference in treatment and the situations are not comparable, there is discrimination.
- If there is a difference in treatment and the situations are comparable, there is discrimination.
- If there is a difference in treatment and the situations are not comparable, there is no discrimination.

(iii) Is there a justification for the discrimination or differentiation, direct or overt discrimination only being justified on (one of) the grounds of justification expressly referred to in the TFEU (see II.C., below)? If the answer to this question is yes, in the context of that justification, may the national tax measure at stake be considered proportionate in light of the purpose pursued by that measure (see II.D., below).

Finally, under Article 18 of the TFEU, the (general) prohibition on discrimination is effective:

- “Within the scope of application of [the Treaty];” and
- “Without prejudice to any special provisions contained therein.”

The latter phrase in Article 18 refers in particular to other Treaty provisions implementing the general principle that it lays down in specific situations. Moreover, the effectiveness of

³⁶ Case C-204/87, *Bekaert*; Case C-54/88, *Nino*; Case C-515/99, *Reisch. Adde*, Case C-139/12, *Caixa d'Estalvis i Pensions de Barcelona*; Case C-464/15, *Admiral Casinos & Entertainment*; and Case C-268/15, *Ullens de Schooten*. See also Case C-192/16, *Fisher*, where the CJEU ruled that TFEU, Art. 355(3) in conjunction with TFEU, Art. 49 or 63 is to be interpreted as meaning that the exercise of the freedom of establishment or the free movement of capital by British nationals between the United Kingdom and Gibraltar constitutes, as a matter of EU law, a situation confined in all respects within a single Member State.

³⁷ See the summary in Case C-130/95, *Giloy v. Hauptzollamt Frankfurt/M-Ost*. See with respect to the Merger Tax Directive: Case C-28/95, *Leur-Bloem* (see III.B., below).

³⁸ E.g., Case C-448/98, *Guimont*.

³⁹ Case C-379/92, *Peralta*; Case C-132/93, *Steen*.

⁴⁰ Case 115/78, *Knoors*; Case C-61/89, *Bouchoucha*.

⁴¹ In certain cases (namely cases that involve restrictions that discriminate or differentiate based not on nationality but on the exercise of the Treaty freedoms), the CJEU uses the concept “unequal treatment” instead of “indirect discrimination” so as to avoid any reference to nationality discrimination (e.g., Case C-264/96, *Imperial Chemical Industries*; Case C-141/99, *AMID*; Case C-436/00, *X&Y*).

EU law cannot vary according to the various branches of national law that it may affect.⁴²

In keeping with this *Hubbard*-rule,⁴³ the CJEU systematically strives towards convergence and similarity in its determination of compatibility of national measures with Treaty freedoms, justified by the common objectives of:

- (i) Realizing an internal market; and
- (ii) The effectiveness of EU law,

irrespective of the market (for products, services and production factors) and irrespective of the area of applicable national legislation (including tax legislation).

C. Grounds of Justification — Context, Overview and Analysis

1. Context

Direct or overt discrimination can be justified only on (one of) the grounds of justification expressly listed in the TFEU, i.e.:

- (i) Public policy;
- (ii) Public security;
- (iii) Public health; and
- (iv) The exercise of public authority⁴⁴ (“closed” justification system).

Indirect or covert discrimination or a measure that is restrictive with respect to the fundamental freedoms may be justified if:

- (i) The measure at issue relies on objective grounds other than nationality; and
- (ii) The measure is proportionate.

There is no exhaustive list of possible “objective grounds” (the “open” justification system). While theoretically established, the borderline between the two types of justification systems does not always seem to be scrupulously respected in CJEU case law.⁴⁵

Broadly, the “objective grounds” test within the open justification system requires the restrictive national measure at issue to have an acceptable (“legitimate”) ground of justification (the “end” or “objective” of the national measure), and that ground must be pursued by proportionate means.

This is an elaboration of the *Cassis de Dijon* (or “rule of reason”) doctrine developed by the CJEU with respect to the free movement of goods.

In *Cassis de Dijon*, the CJEU held that any national measure liable to hinder or make less attractive the exercise of the Treaty freedoms could be justified only if it fulfilled four conditions:

- (i) It must be applied in a nondiscriminatory manner;

(ii) It must be justified by overriding reasons based on the general interest;

(iii) It must be suitable for securing the attainment of the objective that it pursues; and

(iv) It must not go beyond what is necessary to attain that objective.⁴⁶

In other words, an obstacle can be justified under EU law only if it is:

(i) Based on objective considerations independent of the nationality of the persons concerned and;

(ii) Proportionate to the legitimate aim of the national provisions concerned.

The proportionality principle requires that the measures adopted:

(i) Be appropriate or suitable for attaining; or

(ii) Likely to secure the attainment of,

the objective they pursue, and not go beyond what is necessary to attain it.⁴⁷

In other words, national legislation is appropriate for ensuring attainment of the objective pursued only if it genuinely reflects a concern to attain it in a consistent and systematic manner and if there is no less burdensome alternative that is equally capable of realizing the Member State’s policy choice.⁴⁸

2. Overview

In the (direct) tax area, the CJEU has considered various potential justifications for indirect discriminatory or restrictive tax measures, including:

(i) The cohesion of the tax system;

(ii) The loss of tax revenue;

(iii) The prevention of the double use of losses;

(iv) The effectiveness of fiscal supervision;

(v) The principle of territoriality;

(vi) The prevention of tax avoidance; and

(vii) The balanced allocation of taxing powers between Member States.

In particular, since *Marks & Spencer*,⁴⁹ there has been an increasing trend in CJEU case law to put together two or more grounds of justification — in most cases the need to preserve a balanced allocation of taxing powers and the prevention of

⁴² Case 82/71, *Pubblico Ministero Italiano v. SAIL*.

⁴³ As first formulated in (the non-tax) Case C-20/92, *Hubbard*.

⁴⁴ See TFEU, Arts. 45(3) and (4), 51, 52 and 62.

⁴⁵ See, e.g., Opinion of Advocate General Maduro in Case C-446/03, *Marks & Spencer*, para. 33.

⁴⁶ Case 128/72, *Cassis de Dijon*, as further applied and specified in Case C-55/94, *Gebhard*: restrictive measures can be spared only if they satisfy the following four conditions, i.e., they must: (i) be applied in a nondiscriminatory manner; (ii) be justified by imperative requirements in the general interest; (iii) be suitable for securing the attainment of the objective that they pursue; and (iv) not go beyond what is necessary to attain that objective (the “Gebhard formula”).

⁴⁷ In Case C-372/04, *Watts*, the Court also mentioned “reasonableness,” a well-established concept in the German doctrine of *Verhältnismäßigkeit*, as a (third) element of proportionality.

⁴⁸ See, e.g., Case C-250/95, *Futura Participations*; Case C-9/02, *de Lasteyrie du Saillant*; Case C-446/03, *Marks & Spencer*; and Case C-337/08, *X Holding BV*.

⁴⁹ Case C-446/03, *Marks & Spencer*.

tax avoidance — in the combined light of which restrictive tax measures are regarded as:

- (i) Pursuing legitimate objectives compatible with the Treaty;
- (ii) Constituting overriding reasons in the public interest; and
- (iii) Suitable for ensuring the attainment of those objectives.

In parallel, this expansion of the scope of (potential) justification for what, in essence, is held to be a restrictive measure is counterbalanced by a stringent application of the proportionality test (see II.D., below).

3. Analysis

a. Fiscal Cohesion

The concept of “cohesion” or “coherence” of the tax system as a ground of justification for a tax measure was first developed in *Bachmann*⁵⁰ and its companion case *Commission v. Belgium*,⁵¹ which concerned the compatibility with EU law of Belgian tax law provisions conditioning the deductibility for income tax purposes of sickness and invalidity insurance and pension and life insurance on such contributions being paid in Belgium, either to a Belgian undertaking or to the Belgian establishment of a foreign undertaking.

After considering the Belgian legislation at issue to be in principle contrary to the free movement of workers (because of the risk that it might operate particularly to the detriment of workers who were nationals of other Member States), and after rejecting consumer protection and the effectiveness of fiscal supervision as possible grounds of justification, the CJEU acknowledged that provisions such as those contained in the Belgian legislation at issue were justified by the need to ensure the cohesion or coherence of the tax system of which they formed part.

According to the CJEU, there existed a correlation under the Belgian rules between the deductibility of contributions and the liability to tax of sums payable by the insurers under pension and life assurance contracts, i.e., pensions, annuities, capital sums or surrender values under life assurance contracts were exempt from tax where there had been no deduction for contributions (and *vice versa*).

In the CJEU’s view, it followed that in such a tax system the loss of revenue resulting from the deduction of life assurance contributions from taxable income was offset by the taxation of pensions, annuities or capital sums payable by the insurers.

The cohesion of such a system presupposed that, where a State had to allow the deduction of life assurance contributions paid in another Member State, that State had to be allowed to tax the sums payable by the insurers.

The decision in *Bachmann* attracted severe criticism:

- (i) It is questionable whether a national measure held to be overtly discriminatory, as was arguably the case,⁵² could be

justified under the rule of reason, i.e., the open justification system.

- (ii) The decision was believed to represent the adoption of a position antithetical to the free movement of workers, especially as regards distortions and discrimination in taxation, feeding the fear that Member States would henceforth rely on the cohesion defense as an excuse for all sorts of discriminatory national tax rules.

Therefore, in its subsequent case law, the CJEU has shifted towards narrowing down the concept of “fiscal cohesion.” It has done so by insisting on the requirement that, for a measure to be justified on grounds of the cohesion of the national tax system:

- (i) There must be a direct link between the tax concession concerned and the offsetting of that concession by a particular tax levy; and
- (ii) The corresponding benefits and losses must affect the same taxpayer.⁵³

This restrictive approach might explain the fact that the “fiscal cohesion” argument has gradually lost much of its merit⁵⁴ and even seems to have been superseded by the grounds of justification based on the prevention of tax avoidance and the balanced allocation of taxing powers between Member States (see below).

The foregoing does not mean, however, that the fiscal cohesion defense has disappeared from the spotlight altogether.

For example, in *Krankenheim-Wannsee*,⁵⁵ the CJEU upheld the “fiscal cohesion” argument.

In this admittedly fact-specific case, under the Austria-Germany tax treaty, a German resident company with a permanent establishment (PE) in Austria was not taxed in Germany on the profits attributable to the PE. Austria taxed the profits.

In situations where the PE incurred losses in Austria, Austrian law contained no provision for the carrying forward of the losses when the undertaking as a whole made profits.

In such circumstances, to provide loss relief for its resident companies conducting economic activities abroad, the German rules provided that the losses could be deducted from the total income in Germany only if they would be taken into account again at a later date when the PE made profits.

The CJEU found that the “deduction and recapture” rules were necessary to ensure the coherence of the German tax system. In the Court’s view, the reintegration of the amount of the PE’s losses into the results of the principal company was an indissociable and logical complement of their having previously been taken into account.

⁵² In its decision, the CJEU did not expressly state that the Belgian provisions were discriminatory, but merely observed that “the provisions in question may operate to the particular detriment of those workers who are, as a rule, nationals of other Member States.”

⁵³ Case C-324/00, *Lankhorst-Hohorst*; Case C-524/04, *Test Claimants in the Thin Cap Group Litigation*; Case C-281/06, *Jundt*; Case C-330/07, *Jobra*; Case C-169/08, *Presidente del Consiglio dei Ministri*.

⁵⁴ See Case C-296/12, *Commission v. Belgium*.

⁵⁵ Case C-157/07, *Krankenheim Wannsee*.

⁵⁰ Case 204/90, *Bachmann*.

⁵¹ Case 300/90, *Commission v. Belgium*.

Another illustration may be found in *Papillon*,⁵⁶ a case that concerned the French fiscal consolidation regime, which allowed the grouping of French subsidiaries and sub-subsidiaries of a French parent company, but disallowed the grouping of a French sub-subsidiary held via a nonresident subsidiary.

The CJEU considered that the regime concerned amounted to a breach of EU law that was not justifiable on the grounds of the allocation of taxing powers or the prevention of “double dipping” (since the issue was whether a French sub-subsidiary, not a foreign subsidiary, could be included in the fiscal consolidation).

The question arose whether the breach could be justified based on the need to maintain the cohesion of the French fiscal regime and, more specifically, whether there was a direct link between the tax advantage and the offsetting of the advantage by a particular tax levy.

The French Government had argued that any loss resulting from the depreciation of the holding in the sub-subsidiary could not be “neutralized” because the immediate parent was not a French company within the fiscal consolidation regime and that, in these circumstances, it would be too difficult to ascertain whether losses were used twice.

The CJEU dismissed this argument by pointing out that:

(i) Practical difficulties could not of themselves justify the infringement of a freedom guaranteed by the Treaty;⁵⁷

(ii) EU legislation concerning mutual assistance allowed the Member States to request from the competent authorities of the other Member States all information that might be relevant in assessing, among other issues, the corporation tax payable; and

(iii) The tax authorities concerned were entitled to demand from the parent company such documents as they considered necessary to determine whether the provisions made by that company for losses in the value of the shares in the subsidiary could be explained indirectly by a loss of the sub-subsidiary through the provisions of that subsidiary.⁵⁸

Accordingly, the provisions of the French tax code at issue could not, in the CJEU’s opinion, be justified by the need to ensure the cohesion of the French tax system.

b. Loss of Tax Revenue

A reduction in tax revenue is not one of the grounds listed in the closed justification system of the TFEU, nor can it be regarded as a matter of overriding general interest that may be relied on to justify unequal treatment that is, in principle, incompatible with a Treaty freedom.⁵⁹

As such, a loss of tax revenue cannot be regarded as an overriding reason in the public interest that may be relied on to

justify a measure that is, in principle, contrary to a fundamental freedom.⁶⁰

c. Double Use of Losses

The objective of preventing the double use of losses does not constitute an end in itself and, hence, the justification of a restrictive tax measure based on the objective of preventing the double use of losses does not exist as an autonomous ground.⁶¹

Reliance on the objective of preventing the double use of losses alone cannot therefore justify the restriction of a fundamental freedom *a priori*.

This holds true irrespective of whether the issue is prevention of unilateral use or prevention of bilateral use of losses.

In the case of unilateral use, a Member State seeks to preclude the double use of losses in the context of its own tax system. It is, however, up to the Member State itself to prevent this by means of the unrestricted organization of its tax system, if necessary, by adopting specific rules on the prevention of the double use of losses.

In the case of bilateral use, a Member State seeks to prevent a loss from being used both in its own tax system and also, based on the tax rules of another Member State, in that other State’s tax system.

The aspect of prevention of the double use of losses, as developed in CJEU case law, concerns solely the question of whether a Member State has the right, in the context of the balanced allocation of the powers of taxation, not to take into account a loss in its taxation of one of its taxpayers.

That right may derive from the fact that the loss is taken into account in another Member State under whose fiscal jurisdiction the taxation of the profits from the relevant activity falls.

The loss is “attributed” to that other Member State because it taxes the relevant profits. Use in a further Member State that does not tax the profits would possibly represent the “double” use of the losses.

Consequently, the prevention of the double use of losses does not constitute an autonomous justification, but is relevant in so far as it serves to preserve the allocation of the power to tax between the Member States.⁶²

d. Effectiveness of Fiscal Supervision

Maintaining the effectiveness of fiscal supervision has been confirmed by the CJEU as an admissible ground of justification in a number of cases,⁶³ which suggests a certain degree of flexibility on the part of the CJEU in accepting that the constraints of:

- (i) Administration;
- (ii) Collection; and
- (iii) Control

⁵⁶ Case C-418/07, *Papillon*; see also, Case C-269/07, *Commission v. Germany*.

⁵⁷ See also Case C-334/02, *Commission v. France* [2004]; Case C-386/04, *Centro di Musicologia Walter Stauffer*; and Case C-446/04, *Test Claimants in the FII Group Litigation*.

⁵⁸ See, to the same effect, Case C-386/04, *Centro di Musicologia Walter Stauffer*; Case C-150/04, *Commission v. Denmark*; Case C-347/04, *Rewe Zentralfinanz*; and Case C-451/05, *ELISA*.

⁵⁹ Case C-264/96, *Imperial Chemical Industries v. Colmer*.

⁶⁰ Case C-319/02, *Manninen*.

⁶¹ Case C-18/11, *Philips Electronics UK*.

⁶² Opinion of Advocate General Kokott in Case C-18/11, *Philips Electronics UK* and Joined Cases C-39/13, C-40/13 and C-41/13, *SCA Group Holding and Others*.

⁶³ Case C-279/93, *Schumacker* and Case C-55/98, *Vestergaard*. See also Case 120/78, *Rewe-Zentral*; Case C-250/95, *Futura Participations*; Case C-254/97, *Baxter*. The justification was rejected, Case C-324/00, *Lankhorst-Hohorst*.

required in the context of cross-border activities are more cumbersome than those required in the context of domestic activities.

Where this defense is rejected, it is generally because of the CJEU's reservations with respect to the necessity and proportionality of the restrictive measures concerned (see II.D., below).

In *SIAT*,⁶⁴ the CJEU specifically stated that, to ensure the effectiveness of fiscal supervision intended to combat tax evasion, a Member State might apply measures that enable the amount of expenditure deductible in that state as a business expense to be ascertained clearly and precisely.

The CJEU often rejects the effectiveness of fiscal supervision justification by pointing to the extensive provisions for the exchange of direct tax information between Member States in the context of the secondary legislation relating to administrative cooperation and mutual assistance (on administrative cooperation in the field of direct taxation, see XXI., below).

The justification on the grounds of the effectiveness of fiscal supervision is particularly relevant in the context of the extension of the free movement of capital to third countries as embedded in Article 63 of the TFEU (see II.A., above).

In *Skatteverket v. A*,⁶⁵ for example, the effectiveness of fiscal supervision was accepted as an independent and sufficient justification for a tax restriction.

In that case, Swedish tax legislation provided a tax exemption for dividends consisting of shares of a subsidiary of the distributing corporation received from a company resident outside Sweden, subject to a number of conditions.

One of the conditions was that the tax treaty between Sweden and the country of residence of the distributing corporation should contain a provision for the exchange of tax information.

The Sweden-Switzerland tax treaty did not allow for an exchange of tax information as comprehensive as that allowed under the Mutual Assistance Directive or the Organization for Economic Cooperation and Development (OECD) Model Tax Convention.

The taxpayer and the Commission argued that making the exemption dependent on the Swedish authorities' ability under the tax treaty to ensure the cooperation of the Swiss authorities was disproportionate, given that Sweden could require the taxpayer to provide the necessary information to establish that applicable conditions were fulfilled.

However, the Court held that, with respect to third countries, capital movements took place in a different legal context that affected the application of the principle of proportionality.

Since the EU legislation on the exchange of tax information and the requirement to publish company accounts were not applicable, the CJEU held that it was legitimate for a Member State to refuse a tax advantage that was dependent on conditions that it was not able to verify without obtaining information from the third country and which that country was under no contractual obligation to supply.

⁶⁴ Case C-318/10, *SIAT*.

⁶⁵ Case C-101/05, *Skatteverket v. A*.

e. Principle of Territoriality

Another ground of justification invoked by taxpayers is based on the fiscal principle of territoriality.

This defense was accepted by the CJEU in *Futura Participations*.⁶⁶

The case concerned a French company with a branch in Luxembourg that was required, under Luxembourg tax rules, to maintain a set of Luxembourg accounts to be able to carry forward losses. The losses also had to be connected to Luxembourg activities.

The Court noted that both resident taxpayers and nonresidents with branches were taxed in the same way.

Having first conducted a "discrimination" analysis, found that the Luxembourg rules, which limited the basis of assessment to Luxembourg profits and losses, were in keeping with the "fiscal principle of territoriality" and therefore could not constitute discrimination as prohibited by the TFEU.

However, the CJEU turned down the "fiscal principle of territoriality" justification in *X and Y*, *Gerritse* and *Bosal Holding*, among other cases.⁶⁷

In *Marks & Spencer*,⁶⁸ the CJEU considered, in the context of the U.K. group relief regime as applicable at that time, that, in taxing resident companies on their worldwide profits and nonresident companies solely on the profits from their activities in the United Kingdom, the United Kingdom, which was the parent company's Member State, was acting in accordance with the principle of territoriality enshrined in international tax law and recognized by EU law.

However, the fact that the United Kingdom did not tax the profits of the nonresident subsidiaries of a parent company established in its territory did not in itself justify restricting group relief to losses incurred by resident companies.

Arguably, the principle of territoriality is conceptually ill-fitted to be captured under the "rule of reason," i.e., the open justification system, in itself, is not an objective of public interest.

The principle of territoriality allows certain connecting factors to be used to delimit a Member State's taxation rights.

As such, a test of the principle of territoriality should therefore rather be made when the issue of discrimination is examined, i.e., it should be applied at the level of establishing infringement or noninfringement of the prohibition on discrimination by reference to the objective difference between residents and nonresidents.

⁶⁶ Case C-250/95, *Futura Participations*: "The Court has repeatedly held that the effectiveness of fiscal supervision constitutes an overriding requirement of general interest capable of justifying a restriction on the exercise of fundamental freedoms by the Treaty (...). A Member State may therefore apply measures which enable the amount of both the income taxable in that State and of the losses which can be carried forward there, to be ascertained clearly and precisely."

⁶⁷ Case C-200/98, *X AB and Y AB*; Case C-234/01, *Gerritse*; Case C-168/01, *Bosal Holding*.

⁶⁸ Case C-446/03, *Marks & Spencer*.

f. Prevention of Tax Avoidance

In *Imperial Chemical Industries*,⁶⁹ a case that concerned the U.K. group relief regime applicable at that time, the U.K. Government had maintained that the U.K. legislation at issue was designed to:

- (i) Reduce the risk of tax avoidance arising from the ability of members of a consortium to channel the charges of non-resident subsidiaries to a subsidiary resident in the United Kingdom; and
- (ii) Have profits accrue to nonresident subsidiaries.

The purpose of the legislation at issue was therefore to prevent the creation of foreign subsidiaries to be used as a means of depriving the U.K. treasury of taxable revenues.

While principally accepting the right of Member States to tackle tax avoidance, and thereby introducing the concept of “wholly artificial arrangements” as a qualifier for “tax abuse” or “abusive practices,” the CJEU nonetheless rejected the argument as, in its view, the legislation at issue did not have the specific purpose of preventing wholly artificial arrangements set up to circumvent U.K. tax legislation from attracting tax benefits, but applied generally to all situations in which the majority of a group’s subsidiaries were established, for whatever reason, outside the United Kingdom.

The establishment of a company outside the United Kingdom did not, of itself, necessarily entailed tax avoidance, since such a company would in any event be subject to the tax legislation of the State in which it was established.

Furthermore, the risk of charges being transferred, which the legislation at issue was designed to prevent, was, in the Court’s opinion, entirely independent of the question of whether the majority of subsidiaries were resident in the United Kingdom.

The existence of only one nonresident subsidiary would have been enough to create the risk invoked by the U.K. Government.

In a number of subsequent judgments, concerning topics such as:

- (i) Controlled foreign corporation (CFC) legislation;⁷⁰
- (ii) Cross-border loss compensation;⁷¹ and
- (iii) Thin capitalization,⁷²

the CJEU elaborated on this approach.

For example, in *Cadbury Schweppes*,⁷³ the CJEU stated that a national measure restricting the freedom of establishment might be justified where it specifically related to wholly artificial arrangements aimed at circumventing the application of the legislation of the Member State concerned.

Accordingly, for a restriction on the freedom of establishment to be justified on the grounds of the prevention of abusive practices, the specific objective of such a restriction had to be to prevent conduct involving the creation of wholly artificial arrangements that did not reflect economic reality, with a view to escaping the tax normally due on the profits generated by activities carried out in national territory.

According to CJEU, therefore, Member States may apply targeted provisions to fight presumed tax avoidance as long as the taxpayer is entitled to:

- (i) Good commercial reasons for; and
- (ii) The economic substance of, its arrangements.

Given the fact that the provisions at issue addressed specifically cross-border situations, the Court was eager to ensure that mere loss of fiscal revenue was not “dressed up” as abusive tax avoidance.

Moreover, the Court also closely monitored adherence to the principle of proportionality.

In summary, a national measure restricting a fundamental freedom may be justified where:

- (i) The national measure in question specifically targets wholly artificial arrangements designed to circumvent the legislation of the Member State concerned;
- (ii) The specific objective of the relevant restriction is to prevent conduct involving the creation of wholly artificial arrangements that do not reflect economic reality, with a view to escaping the tax normally due on the profits generated by activities carried out in the national territory.⁷⁴

In *Marks & Spencer*,⁷⁵ the CJEU emphasized that the risk of tax avoidance was a stand-alone defense or justification for the Member States when it stated that it was also important, in that context, to make clear that Member States were free to adopt or to maintain in force rules having the specific purpose of precluding from a tax benefit wholly artificial arrangements whose purpose was to circumvent or escape national tax law.

g. Balanced Allocation of Taxing Powers

The jurisprudence concerning the “balanced allocation of taxing powers” was designed by the CJEU to enable Member States to discourage attempts by taxpayers to allocate the tax base at will between different jurisdictions.

The “balanced allocation of taxing powers” justification may be accepted, in particular, where the system in question is designed to prevent conduct capable of jeopardizing the right of a Member State to exercise its tax jurisdiction in relation to activities carried out in its territory.

The concept of the “balanced allocation of taxing powers” was first developed in the landmark decision in *Marks & Spencer*,⁷⁶ which concerned the United Kingdom’s group relief rules that allowed a loss-making company to “surrender” its losses to another group company to be set against that company’s profits.

⁶⁹ Case C-264/96, *Imperial Chemical Industries v. Colmer*.

⁷⁰ Case C-196/04, *Cadbury Schweppes*.

⁷¹ Case C-201/05, *Test Claimants in the CFC and Dividend Group Litigation*.

⁷² Case C-524/04, *Test Claimants in the Thin Cap Group Litigation*.

⁷³ Case C-196/04, *Cadbury Schweppes*. The Court also briefly noted that wholly artificial arrangements jeopardize the balanced allocation between Member States of the power to impose taxes.

⁷⁴ Case C-105/07, *NV Lammers & Van Cleef*.

⁷⁵ Case C-446/03, *Marks & Spencer*.

⁷⁶ Case C-446/03, *Marks & Spencer*.

Under the rules as they stood at the time, such surrenders, however, were only allowed under the U.K. corporation tax code where the respective companies were either U.K.-resident or had permanent establishments (PEs) in the United Kingdom.

Marks & Spencer sought to surrender losses of its Belgian, French and German subsidiaries for use against the profits of the U.K. parent, citing the rights to freedom of establishment and freedom of movement of capital enshrined in the TFEU.

In the CJEU's view, the group relief rules at issue deterred parent companies from establishing subsidiaries in other Member States because, in effect, they conferred a cash advantage on purely domestic groups by allowing them immediate relief for losses.

However, the Court accepted as legitimate the concerns of Member States that allowing cross-border loss relief would:

- (i) Jeopardize a balanced allocation of the power to impose taxes between Member States; and
- (ii) Risk allowing companies the opportunity to engage in:
 - “Double dipping” (i.e., obtaining relief for the same loss in two jurisdictions); and
 - “Loss trafficking” (i.e., transferring losses to companies established in Member States with the highest rates of taxation).

In other words, a blanket restriction on cross-border loss relief would go beyond what was necessary, but it would be acceptable to allow a restriction on cross-border loss relief in situations in which a nonresident subsidiary had not exhausted the possibilities for having the losses incurred in the Member State in which it was situated taken into account in that State:

- (i) For the accounting period concerned; and
- (ii) For previous accounting periods,

and where there was still a possibility that the subsidiary's losses might be taken into account in that State in future periods.⁷⁷

In subsequent years, the CJEU has frequently employed the concept of the “balanced allocation of taxing powers” to give Member States the option of introducing administrative or substantive burdens on cross-border business operations.⁷⁸

Well-known examples include:

- (i) Restrictions on cross-border loss compensation;⁷⁹ and
- (ii) The introduction of an exit tax on unrealized capital gains.⁸⁰

As regards the interrelation between the grounds of justification relating to the need to safeguard a balanced allocation

of the power to tax and those relating to the need to combat abusive practices, in *Marks & Spencer*,⁸¹ the Court recognized the safeguarding of the allocation of the power to tax between Member States as an overriding reason in the public interest that might justify a restriction of the fundamental freedoms.

In that regard, it originally cited as related elements the following:

- (i) The avoidance of the danger that losses may be used twice; and
- (ii) The combating of tax avoidance.

Subsequently, the Court recognized that the safeguarding of a balanced allocation of the power to tax might constitute a ground of justification even in situations in which those additional elements were not both present.⁸²

In other cases, the Court placed particular emphasis on the justification of preventing tax avoidance, under which national measures restricting a fundamental freedom might be justified where they specifically targeted wholly artificial arrangements designed to circumvent the legislation of the Member State concerned.⁸³

Such abusive arrangements therefore constituted simply a particular form of interference in the allocation of the power to tax between Member States.

If artificial arrangements were adopted to remove income from the scope of taxation in one Member State and subject it to taxation in another State, that would qualify as an interference in the balanced allocation of the power to tax.⁸⁴

Accordingly, combating such practices does not, as a general rule, constitute an end in itself but pursues the broader objective of ensuring the right of a Member State to exercise its tax jurisdiction in relation to activities carried out in its territory.

That does not imply, however, that the justification of a balanced allocation of the power to tax may be invoked only when the conditions for invoking the justification of combating abusive practices are also satisfied. Depending on the form and objective of the national legislation under consideration, the safeguarding of a balanced allocation of the power to tax may be decisive either in itself or in conjunction with other grounds of justification.⁸⁵

The Court's position appears to be that the need to combat abusive practices has an auxiliary character, ensuring that the balanced allocation of taxing powers as arranged between Member States is not circumvented by wholly artificial arrangements. The justifications are thus not cumulative.

Paradoxically, however, there has been a noticeable trend for the CJEU, especially since *Marks & Spencer*,⁸⁶ to put together two or more grounds of justification — in most cases the need to preserve a balanced allocation of taxing powers and the

⁷⁷ This was reiterated in Case C-414/06, *Lidl Belgium*, in which the CJEU held that “a measure which restricts the freedom of establishment goes beyond what is necessary to attain the objectives pursued where a nonresident subsidiary has exhausted the possibilities for having the losses incurred in the Member State where it is situated taken into account for the accounting period concerned and also for previous accounting periods and where there is no possibility for that subsidiary's losses to be taken into account in that State for future periods.”

⁷⁸ See, e.g., Case C-347/04, *Rewe Zentralfinanz*; Case C-231/05, *Oy AA*; Case C-303/07, *Aberdeen Property Fininvest Alpha*.

⁷⁹ Case C-231/05, *Oy AA*; Case C414/06, *Lidl Belgium*; Case C337/08, *X Holding*.

⁸⁰ Case C-470/04, *N*.

⁸¹ Case C-446/03, *Marks & Spencer*.

⁸² Case C-231/05, *Oy AA*; Case C414/06, *Lidl Belgium*.

⁸³ Case C-196/04, *Cadbury Schweppes*; Case C-524/04, *Test Claimants in the Thin Cap Group Litigation*.

⁸⁴ Case C-196/04, *Cadbury Schweppes*.

⁸⁵ Opinion of Advocate General Kokott in Case C-311/08, *SGI*, at paras. 56–65.

⁸⁶ Case C-446/03, *Marks & Spencer*.

prevention of tax avoidance — in the combined light of which, restrictive tax measures:

- (i) Were considered to pursue legitimate objectives that were compatible with the Treaty; and
- (ii) Constituted overriding reasons in the public interest, and were considered suitable for ensuring the attainment of those objectives.

In parallel, this expansion of the scope of (potential) justification for what, in essence, is held to be a restrictive measure is counterbalanced by a far more stringent application of the proportionality test.

In the most recent case law of the CJEU, this trend is far less visible or, arguably, may even be considered to have been abandoned altogether.

If none of the grounds of justification is applicable in the first place, a combination of such (non-accepted) grounds of justification does not succeed either.⁸⁷

h. Arm's Length Standard As "Safe Harbor"

A final point of interest is the CJEU's repeated affirmation that the arm's length standard serves as some sort of "safe harbor," i.e., if a transaction is at arm's length, it should never be considered a wholly artificial arrangement.⁸⁸ Doubt has been cast on that affirmation by the CJEU's ruling in *X BV*,⁸⁹ a case that concerned a Dutch interest deduction provision. Following the opinion rendered by Advocate General Emiliou,⁹⁰ the CJEU held that Article 49 of the TFEU "must be interpreted as not precluding national legislation under which, in the determination of a taxpayer's profits, the deduction of interest paid in respect of a loan debt contracted with a related entity, relating to the acquisition or extension of an interest in another entity which becomes, as a result of that acquisition or extension, an entity related to that taxpayer is to be refused in full, where that debt is considered to constitute a wholly artificial arrangement or is part of such an arrangement, even if that debt was incurred on an arm's length basis and the amount of that interest does not exceed that which would have been agreed between independent undertakings."

This seems to be at odds with the proposition apparently put forward in earlier case law to the effect that arm's length conditions apply as a safe harbor with respect to the principle of the "prohibition of abuse of right." The CJEU's current position thus seems to be that the fact that an intra-group loan is made on arm's length terms cannot protect it from being characterized as an "abusive practice," if the loan does not have

valid commercial reasons apart from the obtaining of tax benefits that contradict the purpose of relevant tax provisions and EU law.

This is particularly relevant in the context of the proportionality analysis of a Member State's tax measure.

For example, in *Lexel AB*,⁹¹ which concerned a Swedish interest deduction limitation, the Court held that even where a transaction "represents a purely artificial arrangement without any underlying commercial justification, the principle of proportionality requires that the refusal of the right to a deduction should be limited to the proportion of that interest which exceeds what would have been agreed had the relationship between the parties been one at arm's length."

This position also follows, *a contrario*,⁹² from *X BV*, in which the CJEU held that where a loan is, in itself, devoid of economic justification and, but for the relationship between the contracting companies and the tax advantage sought, would never have been contracted, it is consistent with the principle of proportionality to refuse the deduction of all the interest concerned, since such a wholly artificial arrangement must be ignored by the tax authorities when calculating the corporate tax due. According to the Court, denying a deduction for only a fraction of the interest paid on the loan would allow the taxpayer to obtain a partial, or even the entire, tax advantage sought through abusive means, which would, in turn, call into question the coherence of the anti-abuse regime.

D. Proportionality

An obstacle, hindrance or restriction with respect to a fundamental freedom can be justified (on the ground of one or more justifications discussed in II.C., above) only if it is:

- (i) Based on objective considerations independent of the nationality of the persons concerned; and
- (ii) Proportionate to the legitimate aim of the national provisions.

Specifically, the proportionality principle requires that:

- (i) The (tax) measures adopted are appropriate, suitable or likely to secure the attainment of the objective they pursue; and
- (ii) They do not go beyond what is necessary to attain it.⁹³

In other words, national legislation is appropriate for ensuring the attainment of the objective pursued only if:

- (i) It genuinely reflects a concern to attain it in a consistent and systematic manner; and
- (ii) There is no, less burdensome, alternative that is equally capable of realizing the Member State's policy choice.⁹⁴

The proportionality test is one of the key components of the CJEU's analysis: in a representative number of tax cases in

⁸⁷ Case C-484/19, *Lexel AB*.

⁸⁸ See e.g., Case C-524/04, *Test Claimants in the Thin Cap Group Litigation*; Case C-311/08, *SGL*.

Case C-382/16, *Hornbach-Baumart*; Case C-484/19, *Lexel AB*.

⁸⁹ Case C-585/22, *X BV*.

⁹⁰ In his opinion, the Advocate General had urged the Court to revisit the approach it took in *Lexel*. The CJEU, however, did not follow the Advocate General on this point, arguing that the economic validity of the loan and the related transactions at issue in *Lexel* had neither been challenged before the Court nor examined by it and that, consequently, it cannot be inferred from that judgment that, where a loan and the related transactions are not justified by economic considerations, the mere fact that the terms of the loan correspond to those that would have been agreed between independent undertakings means that the loan and the transactions do not, by definition, constitute wholly artificial arrangements.

⁹¹ Case C-484/19, *Lexel AB*.

⁹² Case C-585/22, *X BV*.

⁹³ In Case C-372/04, *Watts*, the CJEU also referred to "reasonableness," a well-established concept in the German doctrine of *Verhältnismäßigkeit*, as a (third) element of proportionality.

⁹⁴ See, e.g., Case C-250/95, *Futura Participations*; Case C-9/02, *de Lasteyrie du Saillant*; Case C-446/03, *Marks & Spencer*; and Case C-337/08, *X Holding BV*.

which the Court agreed to consider a cause of public interest as being admissible under the rule of reason (i.e., the open justification system), the justification was ultimately denied because it did not satisfy the further condition of “necessity.”⁹⁵

Whether a measure goes beyond what is necessary to achieve its aim is, in the first instance, a matter to be assessed by the Member States themselves, although the CJEU will occasionally make the point that a measure may not be disproportionate to the aim sought, and will sometimes offer guidelines on how a Member State should proceed in its assessment.

E. Selected Case Law

1. General

While the CJEU process of striking down national measures that violate the fundamental freedoms started in the early 1960s, the extension of this process to national (direct) tax measures is a relatively new phenomenon.

Admittedly, as far back as 1960, in the *Humblet* case,⁹⁶ the CJEU had alerted the Member States to the fact that direct tax matters were not entirely beyond the realm of its jurisdiction, but it is generally accepted that the first “real” (direct) tax case was the 1986 ruling in *Avoir Fiscal* (see below).

Subject to certain exceptions, which arguably grow in number in recent years, the adoption of secondary harmonizing (or approximating) legislation on direct tax matters has (repeatedly) proven to be a cumbersome process (mainly due to the unanimity requirement imposed by Article 115 of the TFEU).

The case law of the CJEU has therefore gained (and continues to gain) both momentum and significance.⁹⁷ Under the auspices of the frequently repeated dictum that “although direct taxation is a matter for the Member States, they must nevertheless exercise their direct taxation powers consistently with EU law,”⁹⁸ the CJEU has become the principal source of EU direct tax policy.

This role has resulted in the Court’s jurisprudence concerning direct taxation commonly being referred to as “negative harmonization,” i.e., harmonization achieved as a result of the Member States’ reaction to the CJEU’s tax rulings (resulting in the removal of obstacles to trade).

However, the term is not entirely accurate having regard to the perceived asymmetry of Member States’ reaction to the rulings, which represents a shift away from the harmonization concept and the continued removal of obstacles to trade.

The overview of CJEU case law in the direct tax area that follows below is topical and not intended to be exhaustive.

2. Free Movement of Goods

The TFEU provisions on the free movement of goods have generated relatively few direct tax cases, primarily because the Member States’ fiscal measures affecting trade in goods are instead (potentially) caught by Article 110 of the TFEU (“internal taxation,”) which prevails.⁹⁹

A notable exception is *Newspaper Publishers*,¹⁰⁰ a case that concerned French tax law provisions allowing special reserves or deductions for the acquisition of equipment or buildings used in the publication of newspapers devoted to politics.

A publishing house could not, however, benefit from these special tax provisions if the printing was done outside France.

The CJEU held that because these tax provisions caused French publishing houses to print in France rather than abroad, the measure obstructed intra-EU trade.

As the French Government provided no reasonable justification for the tax provisions, the provisions were prohibited on the grounds that they had an equivalent effect to that of a quantitative import restriction.

*Krantz*¹⁰¹ concerned Dutch legislation enabling goods acquired on hire purchase by a bankrupt company to be seized to pay outstanding taxes, even though property in the goods had not yet passed to the purchasing company.

H. Krantz GmbH & Co. contested this legislation as being contrary to (now) Article 34 of the TFEU because the goods at issue happened to be imported from Germany.

The CJEU dismissed this argument on the grounds that the Dutch legislation applied without distinction to both domestic and imported goods and did not seek to control trade with other Member States.

Furthermore, the CJEU stressed that the likelihood that nationals of other Member States would hesitate to sell goods on installment terms to purchasers in the Netherlands because of the possibility that such goods might be liable to seizure for nonpayment of taxes in the Netherlands was too uncertain and indirect to warrant the conclusion that the Dutch legislation at issue was liable to hinder trade between Member States.

3. Free Movement of Workers

a. Transfer of Residence

In *Biehl*,¹⁰² the CJEU examined the compatibility with EU law of a Luxembourg tax provision under which repayment of overpaid payroll tax was refused if the taxpayer concerned had not been resident in Luxembourg during the entire year of assessment in question.

Mr. Biehl, a German national who resided in Luxembourg during his employment with a Luxembourg undertaking, left Luxembourg on November 1, 1983 and, as a consequence, the Luxembourg tax authorities had refused repayment of payroll tax deducted by his employer in excess of the income tax he

⁹⁵ See, e.g., Case 446/03, *Marks & Spencer*: “(...) the Court considers that the restrictive measure at issue in the main proceedings goes beyond what is necessary to attain the essential part of the objectives pursued.”

⁹⁶ Case 6/60, *Humblet*.

⁹⁷ Currently, tax cases reportedly constitute approximately 10% of all cases decided by the CJEU. However, the majority of these (close to 70%) concern indirect taxation, particularly VAT, rather than direct taxation.

⁹⁸ Case C-264/96, *Imperial Chemical Industries*. See also, e.g., Case C-279/93, *Schumacker*; Case C-80/94, *Wielockx*; Case C-311/97, *Royal Bank of Scotland*; Case C-251/98, *Baars*; C-324/00, *Lankhorst-Hohorst*; Case C-446/03, *Marks & Spencer*.

⁹⁹ On the demarcation line between TFEU, Art. 34 and TFEU, Art. 110, see specifically XIX.C.7., below.

¹⁰⁰ Case 14/84, *Commission v. France*.

¹⁰¹ Case C-69/88, *Krantz GmbH*.

¹⁰² Case 175/88, *Biehl*.

should have paid in accordance with the applicable (progressive) scales.

Referring to its ruling in *Sotgiu*,¹⁰³ the CJEU held that the rules regarding equality of treatment forbade not only overt discrimination by reason of nationality but also covert forms of discrimination that, by application of other differentiation criteria, led to the same result.

Despite the fact that the criterion of permanent residence in the national territory for the purposes of obtaining a refund of over-deducted tax applied irrespectively of the nationality of the taxpayer concerned, there was a risk that it would work in particular against taxpayers who were nationals of other Member States since it was often such persons who would, in the course of the year, leave the country or take up residence there.

As a result, the Luxembourg residency requirement was found to be incompatible with (now) Article 45 of the TFEU.

In an attempt to justify the tax rule at issue, the Luxembourg government claimed that its purpose was to protect the system of progressive taxation.

A taxpayer who took up residence in, or left, Luxembourg in the course of the year would have an advantage over a full-year resident in that his/her income (and, hence, his/her tax liability) could be spread among at least two States.

By contrast, full-year-resident taxpayers with the same annual income, would have to declare all their income in Luxembourg, whether or not sourced in Luxembourg, and would therefore be subject to a higher rate of tax.

The CJEU dismissed this argument because the tax rule at issue also applied in situations where the system of progressive taxation was not compromised, i.e., in situations where the taxpayer leaving or taking up residence in Luxembourg derived no income in the country of origin or destination during the year in question.

A further argument based on the fact that domestic legislation provided for a noncontentious procedure for obtaining repayment of overpaid tax was rejected by the CJEU because the provision of a remedy under this procedure was left entirely to the discretion of the Luxembourg tax authorities.

In *Commission v. Luxembourg*,¹⁰⁴ the *Biehl II* case, which also concerned Luxembourg's refusal to repay excess payroll tax to taxpayers who were not permanent residents of Luxembourg for the entire assessment year, the CJEU reiterated in full the line of reasoning followed in *Biehl*.

Transfer of residence-related restrictions arising in the context of pensions or exit taxes on unrealized capital gains are discussed in II.E.3.d. and II.E.4.f., below, respectively.

Comment: Notwithstanding the above, the TFEU offers no guarantee to an EU citizen that transferring his/her activities to a Member State other than that in which he/she previously resided will be neutral as regards taxation.¹⁰⁵

The Treaty prohibits only direct or indirect discrimination or unjustified obstacles to the exercise of the fundamental free-

doms, whether by the country of origin or by the country of settlement.¹⁰⁶

It does not address disadvantages that arise out of mere disparities between the tax systems of the Member States, such as the transfer of residence from a Member State that applies progressive taxation on income to another Member State that applies a similar system with higher brackets.¹⁰⁷

b. Personal or Family-Related Tax Allowances

The leading case in this area undoubtedly remains *Schumacker*,¹⁰⁸ which concerned a Belgian national who, in 1988 and 1989, exercised a professional activity in Germany as an employee, while remaining resident in Belgium with his wife and children.

In accordance with the terms of the Belgium-Germany tax treaty, Mr. Schumacker's salary had been subjected to withholding at source by his German employer under the salary tax bracket applicable to unmarried resident taxpayers and nonresident taxpayers.

According to Mr. Schumacker, however, his tax liability should have been determined by reference to the salary tax bracket applicable to married resident taxpayers allowing for certain tax advantages:

- (i) The ability to split his income between himself and his spouse, leading to lower progression; and
- (ii) The right to claim a refund of over-withheld salary tax because he derived the major part (in 1988) or all (in 1989) of his professional income from German sources.

This position was rejected by the German tax authorities.

The CJEU first opined that the difference in treatment between resident and nonresident workers, a difference that was also laid down in the OECD Model Tax Convention, was not, as such, discriminatory.

A resident was in a different position from a nonresident since the major part of his or her income was normally centralized in his or her State of residence and that State generally had all the information required to assess the taxpayer's global contributive power, having due regard to his or her personal and family circumstances.

It followed that Article 45 of the TFEU did not, in principle, prevent a Member State from taxing the income of a nonresident more heavily than that of a resident in the same employment.

¹⁰⁶ For an example of indirect discrimination by the country of settlement, see Case C-544/07, *Rüffler*.

¹⁰⁷ For example, the TFEU (in particular Art. 21) does not, as a rule, protect taxpayers against the negative tax consequences of a relative's transfer of residence. In Case C-403/03, *Schempp*, the transfer of residence from Germany to Austria of the taxpayer's ex-wife gave rise to the consequence that he could no longer deduct from his income the maintenance allowance that he paid to her. The CJEU held that there was no breach of TFEU, Art. 21, since the wife had moved to a Member State in which income derived from maintenance payments was not taxable, while in Germany the deductibility of such payments from the income of the payer was balanced by the taxation of such income in the hands of the beneficiary. On the other hand, in relation to a transfer of residence from a Member State to a third country, the CJEU stated in Case C-513/03, *Van Hilten-Van der Heijden*, that the mere transfer of residence from one State to another does not fall within the scope of the free movement of capital, the only freedom applicable to third countries.

¹⁰⁸ Case C-279/93, *Schumacker*.

¹⁰³ Case 125/73, *Sotgiu*.

¹⁰⁴ Case C-151/94, *Commission v. Luxembourg*.

¹⁰⁵ Case C-403/03, *Schempp*. The CJEU has made the same statement in cases involving indirect taxation, e.g., Case C-387/01, *Weigell v. Finanzlandesdirektion für Vorarlberg* and in cases concerning social security regulations, e.g., Cases C-393/99 and C-394/99, *INASTI v. Hervein and Hervillier and Lorthiois and Comtexbel*.

The position was different, however, in a case such as Mr. Schumacker's, where the nonresident derived no significant income from his State of residence, but obtained the major part of his taxable income from an activity performed in the State of employment, with the result that the State of residence was not in a position to take account of his personal and family circumstances.

In such a case, there was no objective difference between the situation of a resident and a nonresident that could justify different treatment with respect to personal reliefs.

The CJEU held that discrimination arose with respect to a taxpayer if the taxpayer's personal and family circumstances were not taken into account:

- (i) In his/her State of residence (because the tax payable there is insufficient); or
- (ii) In his/her State of employment (because he or she is not resident there).

This line of reasoning led the CJEU to consider the German rules at issue to be incompatible with the free movement of workers.

The German government argued, based on the fiscal cohesion principle developed in *Bachmann* (see above), that the discriminatory treatment resulting from its legislation was justified by the need to ensure a coherent application of the tax regime to nonresidents.

Absent such provisions, the personal and family circumstances of nonresidents would be taken into account twice, i.e.:

- (i) Once in the State of residence; and
- (ii) Once in the State of employment,

thus entitling such taxpayers to related tax advantages in both States.

The CJEU dismissed this argument on the grounds that, in that case, the State of residence could not take account of the taxpayer's personal and family circumstances since there was insufficient tax payable there.

Therefore, in situations where a nonresident derived all or a substantial part of his/her professional income from the State of employment, equal treatment under Article 45 of the TFEU required that, in that State, his/her personal and family circumstances be taken into account in the same way as those of resident taxpayers and that the same tax benefits be granted to him/her.

The ruling handed down in *Schumacker* implies that the nondiscrimination principle laid down in the TFEU may require departure from generally applicable principles of international taxation.

Contrary to the latter, the Member State of source may be forced to take into account a nonresident's personal and family circumstances for the purposes of determining his or her income tax liability. This will be the case where the nonresident derives all or almost all of his or her (professional) income from that Member State.

The CJEU did not address the question of how to identify the point at which a nonresident ought to receive the benefits of residence in the State of source.

A threshold was, however, put forward in a Commission Recommendation of December 21, 1993, whereby individuals

who carry on their professional activities in a Member State other than the State in which they are resident should be taxed in the State in which they work and should be entitled to the same tax treatment as that applicable to individuals resident in that State if at least 75% of their income is sourced in that State.¹⁰⁹

The *Schumacker* doctrine has been repeated, and further refined, in subsequent cases, including, for example:

- (i) *Wielockx*,¹¹⁰
- (ii) *Gilly*,¹¹¹
- (iii) *Gschwind*,¹¹²
- (iv) *Zurstrassen*,¹¹³
- (v) *de Groot*,¹¹⁴
- (vi) *Gerritse*,¹¹⁵
- (vii) *Wallentin*,¹¹⁶
- (viii) *D*,¹¹⁷
- (ix) *Blanckaert*,¹¹⁸
- (x) *Conijn*,¹¹⁹
- (xi) *Meindl*,¹²⁰
- (xii) *Gielen*,¹²¹ and
- (xiii) *Hirvonen*.¹²²

In *Ettwein*,¹²³ the CJEU decided (thereby extending the application of the *Schumacker* doctrine beyond intra-EU situations) that:

- (i) Article 1(a) of the Agreement between the European Community and its Member States; and
- (ii) The Swiss Confederation on the free movement of persons, signed in Luxembourg on June 21, 1999, and Articles 9(2), 13(1) and 15(2) of Annex I to that Agreement;

had to be interpreted as precluding legislation of a Member State that refused the benefit of joint taxation using the "splitting" method provided for in that legislation to spouses who were nationals of that State and subject to income tax in that State on their entire taxable income, on the sole ground that

¹⁰⁹ Commission Recommendation of December 21, 1993 on the taxation of certain items of income received by nonresidents in a Member State other than that in which they are resident (OJ L 39 of February 10, 1994, p. 22).

¹¹⁰ Case C-80/94, *Wielockx*.

¹¹¹ Case C-336/96, *Gilly*.

¹¹² Case C-391/97, *Gschwind*.

¹¹³ Case C-87/99, *Zurstrassen*.

¹¹⁴ Case C-385/00, *de Groot*.

¹¹⁵ Case C-234/01, *Gerritse*.

¹¹⁶ Case C-169/03, *Wallentin*.

¹¹⁷ Case C-376/03, *D*.

¹¹⁸ Case C-512/03, *Blanckaert*.

¹¹⁹ Case C-346/04, *Conijn*.

¹²⁰ Case C-329/05, *Meindl*.

¹²¹ Case C-440/08, *Gielen*.

¹²² Case C-632/13, *Hirvonen*.

¹²³ Case C-425/11, *Ettwein*.

their residence was situated in the territory of the Swiss Confederation.¹²⁴

At issue in *Imfeld and Garcet*¹²⁵ was Belgian tax legislation having the effect that a couple residing in Belgium and earning income both in Belgium and in another Member State (i.e., Germany), where one of the members of the couple was taxed separately on his income and could not obtain all of the tax advantages linked to his personal and family circumstances, did not receive a specific tax advantage, because of the way the rules for using that advantage operated, despite the fact that the couple would be entitled to the advantage if they had earned all or most of their income in their Member State of residence.

As Mr. Imfeld was self-employed, the case was decided under Article 49 of the TFEU.

The tax legislation at issue established a tax advantage for couples, specifically in the form of a supplementary tax-free income allowance for dependent children that was set off against the income of the member of the couple who earned the greater part of the couple's income.

However, according to the CJEU, the legislation failed to take any account whatsoever of the fact that, after exercising the freedoms guaranteed by the Treaty, the member of the couple concerned might be in the position of not earning income as an individual in Belgium, with the direct and automatic consequence that the couple would subsequently lose the entire benefit of the advantage.

Irrespective of the tax treatment accorded to Mr. Imfeld in Germany, it was the automatic nature of that loss that was contrary to the freedom of establishment.

The fact that Mr. Imfeld's personal and family circumstances were partially taken into account in Germany with respect to his taxation as an individual and that he was consequently able to receive a tax advantage there could not be relied on by the Belgian Government to demonstrate that there was no restriction on the freedom of establishment.

The CJEU dismissed the justification based on the need to safeguard the balanced distribution of the power of taxation between the Member States by reiterating (as it had already done in *de Groot*)¹²⁶ that such a justification could not be invoked by a taxpayer's State of residence to evade its responsibility, in principle, to grant to the taxpayer the personal and family allowances to which he/she was entitled, unless:

- (i) That State was released by way of an international agreement from its obligation to take full account of the personal and family circumstances of taxpayers residing in its territory who worked partially in another Member State; or
- (ii) The CJEU found that, even in the absence of such an agreement, one or more of the States of employment, with respect to the income taxed by them, granted advantages based on the personal and family circumstances of taxpay-

ers who did not reside in the territory of those States but earned taxable income there.

In that context, the mechanisms used to eliminate double taxation or the national tax systems that had the effect of eliminating or alleviating double taxation, had to permit the taxpayers in the States concerned to be certain that, as an end result, all their personal and family circumstances would be duly taken into account, irrespective of how those Member States had allocated that obligation among themselves, in order not to give rise to inequality of treatment that was incompatible with the Treaty provisions on the freedom of movement for persons and in no way resulted from disparities between national tax laws.

Even if the taxpayer's personal and family circumstances were taken into account simultaneously in two Member States (leading to a double advantage), that fact would, in any event, only be the result of the parallel application of the Belgian and German tax laws, as agreed between those two Member States in the terms set out by the tax treaty concluded between them.

Jacob and Lennertz,¹²⁷ concerned a couple resident in Belgium, one of whom received a pension in Luxembourg that was exempt from tax in Belgium pursuant to the Belgium-Luxembourg tax treaty.

However, the income was nonetheless included in the tax base for the purposes of determining the Belgian individual income tax rate applicable to the non-exempt income (the "exemption with progressivity reservation.")

Building on *Imfeld and Garcet* (see above.), the CJEU held the Belgian inclusion method to be incompatible with Article 45 of the TFEU as it had the effect of depriving taxpayers of a part of the benefit of tax advantages that would otherwise have been granted, had the exempt income been excluded from the tax base at the outset.¹²⁸

In *Kieback*,¹²⁹ the CJEU held that Article 45 of the TFEU precluded national legislation under which a nonresident taxpayer who received all or almost all of his income in a Member State during the first three months of the tax year and subsequently moved to another State, where he took up new employment, could not choose to be subject consecutively to the regimes applicable to resident and nonresident taxpayers in the course of that year, and therefore deduct mortgage interest related to a personal dwelling attributable to those first three months, if that option was available to a taxpayer who resided and worked in that Member State during the first three months of the tax year and subsequently moved to another State to take up new employment for the remainder of the tax year.

The fact that the nonresident taxpayer had gone to live and work in a non-Member State rather than a Member State during the course of the tax year was irrelevant.

See also the case of *X*,¹³⁰ where the CJEU held the Treaty freedoms (in that case, Article 49 of the TFEU, as the taxpayer involved was a self-employed person) to preclude a Member State, the tax legislation of which permitted the deduction of "negative income" relating to a dwelling, from refusing the benefit of that deduction to a self-employed nonresident where

¹²⁴ The availability of "splitting" was at issue for intra-EU situations in *Schumacker*, *Gschwind* and *Zurstrassen* (see *supra*) and the German legislator had indeed subsequently extended the benefit to EU and EEA residents, but not done so for Swiss residents.

¹²⁵ Case C-303/12, *Imfeld and Garcet*.

¹²⁶ Case C-385/00, *de Groot*.

¹²⁷ Case C-174/18, *Jacob and Lennertz*.

¹²⁸ See also, Case C-241/20, *BJ*.

¹²⁹ Case C-9/14, *Kieback*.

¹³⁰ Case C-283/15, *X*.

that person received, within that Member State, 60% of his total income and did not receive, within the Member State where his dwelling was located, income that enabled him to qualify for an equivalent right to deduct.

In *Commission v. Belgium*,¹³¹ the CJEU found that Belgium infringed the TFEU by refusing to allow nonresident taxpayers who earned less than 75% of their worldwide income in Belgium to deduct alimony payments from their taxable income.

In the Court's opinion, this penalized nonresident taxpayers, who had exercised the right of freedom of movement of workers, because the payments could not be deducted from taxable income in either their State of residence or Belgium as the State of employment.

More recently, the *Marhaux*¹³² case concerned a Belgian resident who received employment income in Belgium, Luxembourg and France and who, in Belgium, was allowed to deduct maintenance payments only in proportion to his Belgian-source income, while the corresponding part linked to his French-source income was not effectively taken into account in France. The Court held that Article 45 of the TFEU precludes such a result where resident taxpayers with no foreign-source income benefit fully from the deduction and where, under the applicable bilateral tax convention, the loss of the deduction in the State of residence should have been offset by a corresponding tax advantage in the State of employment. The judgment confirms that the practical application of bilateral tax conventions must not result in a cross-border loss of personal and family tax advantages protected by Article 45 of the TFEU.

c. Income-Related Tax Allowances

In *Gerritse*,¹³³ the CJEU found that German legislation that almost entirely denied the deduction of business expenses from the taxable gross income earned in Germany by nonresidents, while permitting such a deduction to German residents, was incompatible with the free movement of workers.

Taking this one step further, in *Scorpio*,¹³⁴ the CJEU considered that legislation that allowed the deduction of business expenses for nonresidents, but only after payment of income tax through a refund procedure to be initiated by the taxpayer, was contrary to EU law since, according to the Court, commencing such a procedure involved additional administrative and economic burdens.

In *Petersen*,¹³⁵ the CJEU extended its line of reasoning by confirming that Article 45 of the TFEU precluded national legislation of a Member State under which income received for employment activities by a taxpayer who was resident in that Member State and had unlimited tax liability in that State was exempt from income tax if the employer was established in that Member State, but was not so exempt if the employer was established in another Member State.

*Bechtel*¹³⁶ concerned a German provision prohibiting a German resident working in France from deducting contribu-

tions to the French social security system — unlike contributions to the German social security system — for the purposes of calculating the German income tax rate (the employment income being tax exempt in Germany under the Germany-France tax treaty, but taken into account in calculating the German tax rate (exemption with progression clause)). The CJEU held this to be incompatible with Article 45 of the TFEU.

d. Pensions and Social Benefits

The seminal case in the pensions and social benefits area is the famous (but much-criticized) *Bachmann* case. *Bachmann* concerned the compatibility with EU law of Belgian tax provisions conditioning the deductibility for income tax purposes of certain contributions on the contributions being paid in Belgium, either to a Belgian undertaking or to the Belgian establishment of a foreign undertaking. The contributions at issue related to sickness and invalidity insurance, and pensions and life assurance.¹³⁷

Mr. Bachmann, a German national, had concluded various insurance contracts with insurance companies established in Germany prior to taking up residence and being employed in Belgium.

The Belgian tax authorities refused the deduction of related insurance contributions, which Mr. Bachmann continued to pay in Germany.

In line with its reasoning in *Biehl* (see II.E.3.a., above), the CJEU first concluded that the Belgian legislation at issue was, in principle, contrary to EU law because of the risk that it might operate particularly to the detriment of workers who were nationals of other Member States.

The Court subsequently examined whether the discriminatory effect resulting from the Belgian tax rules could be justified by motives of general interest.

After rejecting consumer protection and the effectiveness of fiscal supervision as possible grounds of justification, the CJEU acknowledged that provisions such as those contained in the Belgian legislation at issue were justified by the need to ensure the cohesion of the tax system of which they formed part, and that such provisions were not, therefore, contrary to (now) Article 45 of the TFEU (see II.C.3.a., above).¹³⁸

In *Merida*,¹³⁹ the CJEU considered national legislation provided for in a collective agreement concerning the way in which the basis of assessment for a social benefit is calculated. Specifically, under the legislation concerned, the amount of a social benefit such as interim assistance (*Überbrückungshilfe*) paid by the Member State of employment is calculated in such a way that the tax on wages payable in that State is notionally deducted in determining the basis of assessment of that benefit. This notional deduction applied despite the fact that, under a bilateral tax treaty, salaries, wages and analogous emoluments paid to workers not residing in the Member State of employment are chargeable to tax only in the Member State

¹³¹ Case C-60/21, *Commission v. Belgium*.

¹³² Case C-150/25 [*Marhaux*].

¹³³ Case C-234/01, *Gerritse*; see also Case C-55/98, *Vestergaard*.

¹³⁴ Case C-290/04, *Scorpio*; see also Case C-346/04, *Conijn*.

¹³⁵ Case C-544/11, *Petersen*.

¹³⁶ Case C-20/16, *Bechtel*.

¹³⁷ Case 204/90, *Bachmann*.

¹³⁸ See, however, Case C-296/12, *Commission v. Belgium*, which concerned a similar matter, where the CJEU dismissed the “fiscal cohesion” defense (see C.3.a., above).

¹³⁹ Case C-400/02, *Merida*; see also Case C-329/05, *Meindl*. Compare with Case C-496/15, *Eschenbrenner* (insolvency benefit awarded to a frontier worker).

in which the workers are resident. The CJEU held that Article 45 of the TFEU and Article 7(4) of Council Regulation (EEC) No. 1612/68 of October 15, 1968 precluded such legislation.

Similarly, in *Ruffler*¹⁴⁰ and *Filipiak*,¹⁴¹ the CJEU condemned the refusal by the State of residence to grant the tax deductions ordinarily applicable for payments of health insurance and social security contributions on the grounds that they had been made to an institution located in another Member State.

*Kohll and Kohll-Schlesser*¹⁴² concerned a Luxembourg citizen who had moved back to Luxembourg to retire after being employed in the Netherlands for several years.

The Luxembourg citizen received two pensions in connection with his former employment, i.e.:

- (i) A state pension; and
- (ii) Another pension from his former Dutch employer.

He was refused the benefit of a tax credit in computing his Luxembourg income tax liability.

The CJEU:

- (i) First, emphasized that the situation of a taxpayer such as Mr. Kohll, who received a pension paid in consideration of employment carried out in a Member State other than that of which he was a national, was different from that of a person who had spent their entire working life in a Member State of which they were a national and who had only exercised the right to reside in another Member State after having retired, and who could not therefore rely on the free movement guaranteed by Article 45 of the TFEU.¹⁴³

- (ii) Subsequently held that by:

- Introducing a difference in treatment between taxpayers resident in Luxembourg, depending on the Member State from which the retirement pensions taxable in Luxembourg that they received originated; and
- Refusing the benefit of the tax credit to taxpayers for whom the body liable for payment of the pension was established in the territory of another Member State,

the national legislation at issue was likely to deter workers from seeking or undertaking employment in a Member State other than Luxembourg.

Such legislation therefore entailed a prohibited (and non-justifiable) restriction on the free movement of workers.

Two *Commission v. Netherlands* cases¹⁴⁴ concerned the Dutch wage tax and income tax rules regarding the establishment and maintenance of pension capital transfer requirements imposed on employees emigrating from the Netherlands.

The CJEU held the Dutch conditions for tax-free outbound transfers of pension capital to be incompatible with Article 45 of the TFEU.

This was because, under the applicable rules, employees who accepted employment in an EU Member State other than the Netherlands and wished to transfer the value of their pension entitlements to that other State were, in otherwise similar circumstances, put at a tax disadvantage compared to employees working in the Netherlands who changed employment there and transferred the value of their pension entitlements to another pension insurance institution established in the Netherlands. In the latter case the establishment and maintenance of pension capital transfer requirements at issue did not apply.

e. Immovable Property

In *Ritter-Coulais*,¹⁴⁵ the CJEU held a German law provision concerning rental income losses to be incompatible with the free movement of workers.

The provision concerned did not take into account rental income losses (“negative income”) relating to the use of a private dwelling in another Member State for the purposes of determining the rate of progressive taxation, whereas positive income deriving from the use of a dwelling situated in Germany was taken into account for those purposes.

More specifically, the Court decided that Article 45 of the TFEU precluded national legislation that did not permit natural persons in receipt of income from employment in one Member State and assessable to tax on their total income in that State to have income losses relating to their own use of a private dwelling in another Member State taken into account for the purposes of determining the rate of tax applicable to their income in the first state, when positive rental income relating to such a dwelling was taken into account.

A similar provision in Luxembourg law was sanctioned for the same reason in *Lakebrink*.¹⁴⁶

The same reasoning was also applied in *Renneberg*,¹⁴⁷ which concerned the deduction of negative rental income resulting from mortgage interest paid by a Belgian resident who derived most of his taxable income from Dutch sources, in relation to his dwelling in Belgium.

The CJEU held that (now) Article 45 of the TFEU precluded national legislation under which an EU national who was not resident in the Member State in which he received all or almost all of his taxable income could not, for the purposes of determining the basis of assessment with respect to that income in that Member State, deduct negative income relating to a house owned by him and used as a dwelling in another Member State, when a resident of the first Member State might deduct such negative income for the purposes of determining the basis of assessment with respect to his/her income.

In *Commission v. Portugal*,¹⁴⁸ the CJEU considered national fiscal provisions making entitlement to exemption from tax on capital gains arising from the transfer for valuable consideration of real property intended for the taxable person’s own and permanent residence or that of a member of his/her family sub-

¹⁴⁰ Case C-544/07, *Rüffler*.

¹⁴¹ Case C-314/08, *Filipiak*.

¹⁴² Case C-300/15, *Kohll and Kohll-Schlesser*.

¹⁴³ See C-520/04, *Turpeinen*. The reasoning is that, since pensioners are not workers, they can only invoke the free movement of citizens (TFEU, Art. 21) when challenging the restrictive taxation of pensioners. However, if their pension rights arise from occupational income, the disputed tax rule must be tested against TFEU, Art. 45.

¹⁴⁴ Case C-360/22, *Commission v. Netherlands*; Case C-459/22, *Commission v. Netherlands*.

¹⁴⁵ Case C-152/03, *Ritter-Coulais*; see also Case C-431/01, *Mertens*. In Case C-35/08, *Busley and Cibrian Fernandez*, the CJEU further specified that Germany could not apply more favorable depreciation rules to immovable property acquired or constructed on its national territory.

¹⁴⁶ Case C-182/06, *Lakebrink*.

¹⁴⁷ Case C-527/06, *Renneberg*.

¹⁴⁸ Case C-345/05, *Commission v. Portugal*.

ject to the condition that the gains realized should be reinvested in the purchase of real property situated in national territory to be in breach of, among other provisions, the free movement of workers.

In the same vein, in *Commission v. Sweden*,¹⁴⁹ the CJEU found Swedish tax provisions that made:

(i) Entitlement to the deferral of taxation on capital gains arising from the sale of a private residential property; or

(ii) A right to reside in a private cooperative property conditional on the newly acquired residence also being on Swedish territory incompatible with, among other provisions, the free movement of workers.

A similar conclusion prevailed in *Commission v. Germany*,¹⁵⁰ where the CJEU found that a provision of national law that made the granting of the subsidy for owner-occupied dwellings to which persons liable to unlimited taxation of their income in a Member State were entitled, subject to the condition that the dwellings built or purchased by those persons for their own occupation should have been situated in that Member State, was contrary to the free movement of workers (and the freedom of establishment).

f. “Horizontal Discrimination”

*Sopora*¹⁵¹ concerned an issue of differentiation not between nationals and non-nationals (i.e., “vertical discrimination,”) but, rather, between different non-nationals (i.e., “horizontal discrimination.”)

At issue were “extraterritorial costs,” which, under Dutch wage tax rules, employers might reimburse, exempt from tax, to qualifying employees.

In principle, the reimbursement related to costs actually incurred by incoming workers as a result of staying outside their countries of origin to work in the Netherlands.

However, irrespective of the costs actually incurred, there was also a flat-rate rule whereby “extraterritorial costs” were deemed to amount to 30% of the wage tax base.

One of the application conditions of the flat-rate rule was that the employee concerned should reside more than 150 km from the Dutch border for two thirds of the two-year period before commencing employment in the Netherlands.

This requirement led to the territorial exclusion of (certain) workers from Belgium, Germany, France, Luxembourg or the United Kingdom (as opposed to workers from other Member States).

The CJEU held that the 150 km condition for the 30% flat-rate rule to apply did not violate Article 45 of the TFEU, unless it was set in such a way that it would systematically give rise to the clear overcompensation with respect to the extraterritorial expenses actually incurred (which was a matter for the referring court to ascertain).

The importance of the *Sopora* decision lies in the CJEU’s finding that, at least in relation to the free movement of workers (Article 45 of the TFEU):

- “Horizontal comparisons” are possible; and

- Differentiations by domestic law between comparable situations need to be justified if they are to withstand scrutiny under EU law.

Comment: It is unclear whether a “horizontal comparison” would also be possible under Articles 49, 56 and 63 of the TFEU, as those provisions seem to focus on “vertical” comparisons.

In her opinion in *Sopora*,¹⁵² Advocate-General Kokott stressed that, with regard to the question of whether the fundamental freedoms also prohibited differentiation between nationals of different Member States, the CJEU had, up to this point, given varying signals:

(i) On the one hand, the Court rejected the view that unequal treatment depending on the Member State of establishment alone constituted an impairment of freedom of establishment under Article 49 of the TFEU (*Columbus Container Services*)¹⁵³ and, with regard to the free movement of capital under Article 63(1) of the TFEU, which also included third countries, the Court did not view the differing treatment of capital gains, depending on the third country in which they originated, as falling under the protection of that provision (*Haribo*).¹⁵⁴

(ii) On the other hand, also in the context of free movement of capital, the Court found an impairment of the fundamental freedom by reason of the unequal treatment of various other Member States by the State of origin (*Orange European Smallcap Fund*).¹⁵⁵

(iii) In other decisions, both in the context of the free movement of capital and the freedom of establishment, the Court had at least examined whether the differing treatment of various nonresidents constituted an impairment of the fundamental freedom in the specific case in question (*D. and Test Claimants in Class IV of the ACT Group Litigation*).¹⁵⁶

Thus, the position remains ambiguous.

4. Freedom of Establishment

a. Secondary Establishments, Branches and Agencies (Inbound and Outbound)

In *Avoir Fiscal*,¹⁵⁷ a trend-setting case that concerned an inbound secondary establishment situation (i.e., a case in which the position in the host State at the level of the secondary establishment was considered), the CJEU tested the compatibility of the (now repealed) French *avoir fiscal* rules with the freedom of establishment.

Under those rules, a dividend distributed by a French company to its French resident shareholders carried a tax credit (the *avoir fiscal*) equal to 50% of the net dividend (or 33.33% of the gross dividend) as part of the imputation system.

¹⁵² Opinion A–G Kokott of November 13, 2014, at paras. 24–26.

¹⁵³ See Case C-298/05, *Columbus Container Services*.

¹⁵⁴ See Joined Cases C-436/08 and C-437/08, *Haribo*.

¹⁵⁵ See Case C-194/06, *Orange European Smallcap Fund*.

¹⁵⁶ See Case C-376/03, *D.* and Case C-374/04, *Test Claimants in Class IV of the ACT Group Litigation*.

¹⁵⁷ Case 270/83, *Commission v. France*.

¹⁴⁹ Case C-104/06, *Commission v. Sweden*.

¹⁵⁰ See also Case C-152/05, *Commission v. Germany*.

¹⁵¹ Case C-512/13, *Sopora*.

The *avoir fiscal* was designed to give some relief from the double taxation resulting from the income tax being imposed both on the company distributing the dividends and the recipient of the dividends.

At issue in *Avoir Fiscal* was France's refusal to extend the *avoir fiscal* benefit to PEs of foreign companies, i.e., branches and agencies in France of insurance companies whose registered offices were in another Member State, with respect to dividends paid to them by French companies on the same terms as applied to insurance companies whose registered offices were in France.

The French government sought to demonstrate that the difference in treatment at issue was justified based on the distinction between residents and nonresidents, which, as an essential and internationally accepted distinction in tax law, should also apply in the context of the freedom of establishment.

The CJEU rejected this argument.

The Court considered that the freedom of establishment, as one of the fundamental principles of the EU, was intended to:

- Ensure that all nationals of a Member State who established themselves in another Member State, even if that establishment was only secondary, for the purposes of pursuing activities there as self-employed persons, received the same treatment as nationals of that State; and
- Prohibited, as a restriction on the freedom of establishment, any discrimination on the grounds of nationality resulting from the legislation of that Member State, even if that discrimination was only of a limited nature.

Even if it was possible that a distinction based on the location of the registered office of a company or the place of residence of a natural person might, in certain circumstances, be justified in an area such as tax law, it had to be observed that French tax law did not distinguish, for the purposes of determining the income liable to corporation tax, between companies having their registered offices in France and French branches or agencies of companies whose registered offices are abroad.

By treating the two forms of establishment in the same way for the purposes of taxing their profits, the legislature of that Member State had in fact admitted that there was no objective difference between their positions with regard to the detailed rules and conditions relating to that taxation that could justify different treatment. In such circumstances, the French rules could not, without giving rise to discrimination, treat the two forms of establishment differently as regards the granting of a tax advantage such as the *avoir fiscal*.

The French government further claimed that the difference in treatment was, in fact, due to the particular characteristics of, and the differences between, the tax systems of the various Member States. Given the lack of tax harmonization in this field, the distinction embodied in French tax law was necessary to prevent tax avoidance.

The CJEU dismissed this argument on the grounds that the absence of harmonization could not justify a difference in treatment that was incompatible with the right of establishment.

Although it was true that, in the absence of such harmonization, a company's tax position depended on the national law applied to it, the freedom of establishment prohibited Member States from imposing conditions on the pursuit of ac-

tivities by persons exercising that right that differed from those imposed on their own nationals.

More importantly, the CJEU considered that the risk of tax avoidance could not be relied on in this context because (now) Article 49 of the TFEU did not permit any derogation from the fundamental principle of freedom of establishment on such grounds.

Finally, the CJEU dismissed the French government's argument that the difference in treatment was justified in the light of the bilateral agreements concluded with other Member States.

According to the Court, the rights conferred by (now) Article 49 of the TFEU were unconditional and a Member State could not make respect for them subject to the contents of a double taxation agreement concluded with another Member State.

In particular, Article 49 did not permit those rights to be made subject to a condition of reciprocity imposed for the purposes of obtaining corresponding advantages in other Member States. See also II.F.1., below.

The basic thrust of *Avoir Fiscal*, following which host States are obliged to grant "national treatment" when companies and individuals from other Member States establish themselves on their territory, has since been confirmed on various occasions.

In *Commerzbank*,¹⁵⁸ a German company with a branch in the United Kingdom sought equal treatment with U.K. resident companies in relation to a repayment supplement granted by the United Kingdom's revenue authorities when tax was overpaid.

U.K. rules, however, limited the availability of the repayment supplement to companies resident in the United Kingdom.

The CJEU concluded that the use of the criterion of fiscal residence was liable to work more particularly to the disadvantage of companies having their seat in other Member States as it was most often those companies that were resident for tax purposes outside the territory of the Member State in question.

Accordingly, the U.K. rules at issue were held to entail unequal treatment.

*Halliburton*¹⁵⁹ concerned an American parent company with subsidiaries in Germany and the Netherlands carrying out a group reorganization involving the transfer of a Dutch PE of the German subsidiary to the Dutch subsidiary, where the latter was denied a tax concession that would have been granted had the reorganization involved two Dutch companies.

The CJEU held that the payment of tax on the sale of immovable property constituted a burden that rendered the conditions of sale of the property more onerous and thus had repercussions for the position of the transferor (the German company).

In a case such as this, the vendor was in a distinctly less favorable position than if it had chosen the form of a public or private limited company instead of that of a PE for its business in the Netherlands.

¹⁵⁸ Case C-330/91, *Commerzbank*.

¹⁵⁹ Case C-1/93, *Halliburton*.

Despite the fact that the different treatment only had an “indirect effect” on companies resident in other Member States, it still constituted “discrimination on grounds of nationality.”

In *Saint-Gobain*,¹⁶⁰ Germany had denied certain tax advantages to a German branch of a French company that it ordinarily granted to German resident companies with respect to certain dividends received from foreign companies.

The dividends in question were received by the German branch from companies resident in the United States and Switzerland.

The German branch was denied concessions that were designed to prevent such dividends from being taxed again in Germany on the grounds that the Germany-United States and Germany-Switzerland tax treaties restricted the reliefs to German resident companies.

The CJEU concluded that Germany’s refusal to grant the tax concessions on the grounds that the tax reliefs were limited to companies that were resident in Germany:

- Imposed less favorable treatment on a nonresident company operating in Germany via a PE; and
- Made it less attractive for a nonresident company operating in Germany via a PE to hold shares via its German branch.

By implication, that restricted the freedom to choose the most appropriate legal form for the pursuit of the taxpayer’s activities in another Member State, which the second sentence of (now) Article 49 of the TFEU expressly confers on economic operators.

The Court rejected all the grounds of justification advanced by Germany:

- (i) The “resident/nonresident” distinction;
- (ii) The need to prevent a reduction in tax revenue;
- (iii) The conclusion of tax treaties with third countries not coming within the sphere of EU competence; and
- (iv) The fact that the balance inherent in such tax treaties would be disturbed if the benefits of their provisions were extended to companies established in Member States that were not parties to such treaties.

At issue in *Royal Bank of Scotland*¹⁶¹ was the differential treatment of branches in the host Member State in terms of tax rates.

A branch of a U.K. bank located in Greece was charged a 40% tax on its branch profits compared to the 35% tax on the profits of a bank resident in Greece.

A lower tax rate was thus available to companies with their seat in Greece but not to companies with their seat or registered office in other Member States.

The CJEU held that such different treatment was incompatible with the right of establishment and was not justified because there was no objective difference between the two categories of companies.

In *CLT-UFA*,¹⁶² a very similar case, a Luxembourg company with a German branch was subject to a rate of tax of 42%.

German resident companies, on the other hand, were subject to tax at either 30% or 33.5%.

In line with its earlier case law, the CJEU concluded that it was necessary to apply a tax rate to the profits made by a branch that was equivalent to the overall tax rate that would have been applicable in the same circumstances to the distribution of the profits of a subsidiary to its parent company.

In *Futura Participations*,¹⁶³ a French company established a branch in Luxembourg that was required under Luxembourg tax rules to maintain a set of Luxembourg accounts to enable it to carry forward losses.

The losses also had to be connected to Luxembourg activities.

The CJEU held this requirement to constitute a restriction on the freedom of establishment as the French company, if it wished to carry forward branch losses in Luxembourg, in addition to its own accounts, had to keep an additional set of accounts in Luxembourg maintained in accordance with Luxembourg accounting rules.

While the Court confirmed that, as no harmonizing rules had been adopted to determine the basis of assessment for direct taxes, it was within the competence of a Member State to draw up its own rules governing the determination of profits, income, expenditure, deductions and exemptions, as well as the amounts of each of them that were to be included in the calculation of taxable income or losses that might be carried forward, it added that such competence had to be exercised in compliance with EU law.

As regards outbound secondary (permanent) establishment situations, in which the position in the home or “origin” State at the level of the head office (as opposed to the position in the host State at the level of the secondary establishment) is considered, the seminal case is undoubtedly *AMID*,¹⁶⁴ which concerned the tax loss imputation rules in Belgium.

In 1981, *AMID*, a Belgian company with a PE in Luxembourg, suffered a loss in Belgium while its Luxembourg PE made a profit.

In 1982, *AMID* made a profit in Belgium.

Under Luxembourg tax law, it was impossible for *AMID* to set off the Belgian loss against the Luxembourg profit.

AMID, therefore, sought to deduct the Belgian loss of 1981 from the Belgian profit of 1982.

The Belgian tax authorities denied this deduction on the grounds that, under the Belgian tax loss imputation rules, the Belgian loss should have been set off against the Luxembourg profit of 1981, with the result that it could not be deducted from the Belgian profit of 1982.

In the CJEU’s view, the Belgian legislation at issue limited the possibility of a company carrying forward losses incurred in Belgium in a previous tax period where, in that same tax period, the company made a profit in another Member State through the intermediary of a PE, whereas it would be possible to set off those losses if the establishments of the company were situated exclusively in the Member State of origin (i.e., Belgium).

¹⁶⁰ Case C-307/97, *Saint-Gobain*.

¹⁶¹ Case C-311/97, *Royal Bank of Scotland*.

¹⁶² Case C-253/03, *CLT-UFA*.

¹⁶³ Case C-250/95, *Futura Participations*.

¹⁶⁴ C-141/99, *AMID*.

Thus, by setting off domestic losses against profits exempted under the terms of a tax treaty, the legislation of that Member State established a different tax treatment as between a company incorporated under domestic law that had establishments only in its national territory and a company that had an establishment in another Member State.

Where such a company had a PE in a Member State other than the Member State of origin and a double taxation agreement bound the two States, the company was likely to suffer a tax disadvantage that it would not have had to suffer if all its establishments had been situated in the Member State of origin.

In view of the foregoing, the CJEU concluded that (now) Article 49 of the TFEU precludes legislation under which a company's ability to set off a previous year loss against its current year profits differs depending on the location of the company's establishments. Specifically, Article 49 precludes legislation of a Member State under which a company incorporated under the national law of that State and having its seat in that State may deduct a loss incurred in the previous year from its current year taxable profits only if the loss was not capable of being set off against the profits made in that previous year by one of its PEs situated in another Member State, when the loss, although set off, cannot be deducted from taxable income in either of the Member States concerned, while, on the other hand, the loss would be deductible if the establishments of the company were situated only in the Member State in which it is incorporated and has its seat.

Another famous outbound secondary establishment case is *Lidl Belgium*.¹⁶⁵

In that case, Lidl Belgium GmbH & Co. KG, a company fiscally resident in Germany, sought to offset losses suffered by its Luxembourg PE against its German profits.

However, since the income of a Luxembourg PE of a German company was exempted from German tax under the German-Luxembourg tax treaty, the German tax authorities argued that the Luxembourg losses could not be offset against German domestic profits.

According to the CJEU, such a tax regime involved a restriction on the freedom of establishment, since the tax situation of a company that had its registered office in one Member State and a PE in another Member State was less favorable than it would have been if the latter had been established in the first Member State.

Due to that difference in tax treatment, a resident company could be discouraged from carrying on its business through a PE situated in another Member State.

Nevertheless, in the Court's view, such a tax regime could, in principle, be justified in the light of the need to safeguard the allocation of the power to tax between the Member States and the need to prevent the danger that the same losses would be taken into account twice — considerations that, taken together, pursue legitimate objectives compatible with the Treaty and thus constitute overriding reasons in the public interest, provided the regime concerned was proportionate to those objectives.

*Krankenheim Ruhesitz am Wannsee-Seniorenheimstatt*¹⁶⁶ concerned a limited liability company resident in Germany that operated a PE in Austria from 1982 to 1994.

During the period 1982 to 1990, under the German tax law then in force, the losses incurred by the Austrian PE were taken into account in calculating the taxable income generated by Krankenheim in Germany.

Between 1991 and 1994, the Austrian PE was profitable. The profits made by the Austrian PE between 1992 and 1993 were taxed in Austria without taking into consideration the losses previously incurred.

Under Austrian tax law, the deduction of losses incurred by a PE was only allowed if it was not possible to take the losses into account in the State in which the company owning the PE was established.

On the other hand, Germany added the profits made by the PE in Austria during the period from 1991 to 1994 to the total income obtained by Krankenheim in Germany.

As such, Austria retrospectively taxed ("recaptured") the amounts previously deducted in the context of national taxation with respect to the losses incurred by the PE in Austria.

In the case of a German PE, however, there would have been no recapture at all.

The case was considered under the provisions of the European Economic Area (EEA) Agreement on the freedom of establishment, as Austria did not accede to the European Union until January 1, 1995.

Referring to its judgment in *Lidl Belgium*, the CJEU reiterated its position that provisions allowing losses incurred by a PE to be taken into account in calculating the profits and taxable income of the principal company constituted a tax advantage.

Granting or not granting such an advantage with respect to a PE of a company situated in a Member State other than that in which that company was established therefore had to be regarded as a factor likely to affect the freedom of establishment.

According to the Court, by allowing losses incurred by the PE in Austria to be deducted from the profits made by the principal company in the context of that company's taxation in Germany, the German legislation at issue granted a tax advantage to the resident company with a PE in Austria, in the same way as if that PE had been in Germany.

However, by subsequently proceeding to reintegrate losses incurred by the PE into the basis of assessment of the principal company when the latter made profits, the German tax system withdrew the benefit of that tax advantage and, consequently, the system had to be considered to entail a restriction on the freedom of establishment.

Nonetheless, the CJEU noted that the reintegration of losses provided for by the German tax system could not be dissociated from the fact that they had already been taken into account earlier. In the Court's view, such reintegration, in the case of a company with a PE in another State in relation to which that company's State of residence had no power of taxation (as the referring court had indicated), should have been seen as reflecting a logical symmetry in that there was a direct, personal and material link between the two elements of the tax mechanism

¹⁶⁵ Case C-414/06, *Lidl Belgium*.

¹⁶⁶ Case C-157/07, *Krankenheim Ruhesitz am Wannsee-Seniorenheimstatt*.

at issue, the reintegration being the logical complement of the deduction previously granted.

The CJEU therefore concluded that the restriction that followed from the reintegration was justified by the need to guarantee the coherence of the German tax system.

The Court added that the restriction was appropriate for achieving this objective, because it operated in a perfectly symmetrical manner, i.e., only deducted losses were reintegrated the restriction was entirely proportionate to the objective pursued, since the reintegrated losses were reintegrated only up to the amount of the profits made.

The CJEU followed the same analysis in arriving at a similar conclusion in *Timac Agro Deutschland*.¹⁶⁷ The CJEU held that Article 49 of the TFEU did not preclude a Member State's tax regime that, in the event of the transfer by a resident company to a nonresident company within the same group of a PE situated in another Member State, prevented the resident company taking into account in its tax base the losses of the establishment transferred where, under a double taxation agreement, the exclusive power to tax the profits of that establishment laid with the Member State in which the establishment was situated.

This follows from an *a contrario* reasoning in *Nordea Bank Danmark*,¹⁶⁸ where the Court found that Article 49 of the TFEU (and Article 54 of the TFEU and Articles 31 and 34 of the Agreement on the European Economic Area of May 2, 1992) precluded legislation of a Member State under which, in the event of the transfer by a resident company to a nonresident company in the same group of a PE situated in another Member State or in another State that was party to the EEA Agreement, the losses previously deducted with respect to the establishment transferred were reincorporated into the transferring company's taxable profit, insofar as the first Member State taxed both the profits made by that establishment:

- (i) Before its transfer; and
- (ii) Resulting from the gain made on the transfer.

In *Argenta*,¹⁶⁹ the issue was the application of the Belgian notional interest deduction (NID)¹⁷⁰ by taxpayers having foreign PEs.

Under the then applicable rules, the NID was the deemed interest expense that Belgian companies and Belgian establishments of foreign companies were entitled to calculate annually on the amount of their total "adjusted" equity and deduct for tax purposes, thus reducing their tax bases.

Where a company had a foreign establishment whose income was tax exempt under the terms of an applicable tax treaty, one of the adjustments consisted of reducing the base amount by any positive difference between:

- (i) The net book value of assets allocated to the foreign establishment; and
- (ii) The liabilities allocated to that establishment.

On this basis, *Argenta*, a bank established in Belgium, was denied the NID on its equity to the extent of the net asset value of its Dutch PE.

The CJEU held this to be incompatible with Article 49 of the TFEU, which, in its view, had to be interpreted as precluding national legislation under which, for the purposes of calculating a deduction granted to a company subject to full tax liability in a Member State:

- (i) The net value of the assets of a PE situated in another Member State was not taken into account when the profits of that PE were not taxable in the first Member State under the terms of a double taxation agreement; and
- (ii) The assets attributed to a PE situated in the territory of the first Member State were taken into account for these purposes.

The Court further found that this restriction was not justifiable based on either the need to preserve the coherence of the fiscal system or the balanced allocation of taxing powers between EU Member States.

Belgium adapted its legislation to align with the CJEU's ruling. Under the amended rules, where the profits of a foreign PE were exempt in Belgium under a tax treaty, the net value of the PE's assets was initially taken into account when calculating the NID to the Belgian company.

The NID was subsequently reduced by the lower of:

- (i) The part of the deduction for risk capital relating to the PE; or
- (ii) The positive result generated by the PE.

In contrast, this deduction did not apply where a company operated solely domestically.

In *Argenta Spaarbank*,¹⁷¹ the CJEU observed that, although the NID might be higher for companies operating purely domestically, in the absence of any other differentiating factors, the basis of assessment of a Belgian company that solely operated domestically was also higher.

On the other hand, where a Belgian company had a foreign PE and the profits of that PE were exempt from tax in Belgium under a tax treaty, the results of the PE were excluded from the tax base of the Belgian company.

In those circumstances, the Court held that the different treatment (i.e., the application of different computation methods) did not constitute disadvantageous treatment of Belgian companies operating abroad through PEs and the rule did not violate the freedom of establishment principle.

*Commission v. Germany*¹⁷² concerned German rollover relief rules allowing a tax-free transfer of capital gains resulting from the disposal of a qualifying fixed asset to a qualifying replacement asset. The CJEU held that, by making the benefit of the deferral of taxation of the capital gains realized on the sale of a capital asset forming part of the assets of a PE of the taxable person located in German territory subject to the condition that those gains were reinvested for the purposes of acquiring replacement assets forming part of the assets of a PE of the

¹⁶⁷ Case C-388/14, *Timac Agro Deutschland*.

¹⁶⁸ Case C-48/13, *Nordea Bank Danmark*.

¹⁶⁹ Case C-350/11, *Argenta*.

¹⁷⁰ The Belgian NID regime has been abolished in its entirety as of financial year 2023. An (alternative) NID regime might have to be reintroduced if the DEBRA Proposal launched by the Commission materializes into a Directive.

¹⁷¹ Case C-459/18, *Argenta Spaarbank*.

¹⁷² Case C-591/13, *Commission v. Germany*.

taxable person located within that same territory, the rollover scheme at issue constituted a restriction on the freedom of establishment.

b. Cross-Border Losses — Group/Consortium Relief

*Imperial Chemical Industries*¹⁷³ (ICI) was a case in which ICI and Wellcome Foundation Ltd., both U.K. companies, formed a consortium through which they beneficially owned 49% and 51%, respectively, of Coopers Animal Health (Holdings) Ltd (CAHH), whose sole business was to hold shares in 23 trading companies that were its subsidiaries:

- Four of the subsidiaries, including Coopers Animal Health Ltd (CAH), were resident in the United Kingdom;
- Six of the subsidiaries were resident in other Member States; and
- The remaining 13 subsidiaries were resident in third countries.

In three tax years, CAH incurred losses and ICI sought to set 49% of those losses against its chargeable profits for the years in question.

The U.K. Inland Revenue refused the application for such tax relief on the grounds that CAHH was not a “holding company” within the meaning of the (then) applicable U.K. consortium relief tax rules because the majority of its subsidiaries were not bodies corporate resident in the United Kingdom.

In the CJEU’s opinion, the freedom of establishment precluded legislation of a Member State that, in the case of com-

panies established in that State and belonging to a consortium through which they controlled a holding company by means of which they exercised their right to freedom of establishment to set up subsidiaries in other Member States, made a particular form of tax relief subject to the requirement that the holding company’s business consisted wholly or mainly in the holding of shares in subsidiaries that were established in the Member State concerned.

The CJEU dismissed the United Kingdom’s defense that the legislation in question was required to prevent tax avoidance on the grounds that such rules did not have the specific purpose of preventing wholly artificial arrangements set up to circumvent U.K. tax legislation from attracting tax benefits, but applied generally to all situations in which the majority of a group’s subsidiaries were established, for whatever reason, outside the United Kingdom.

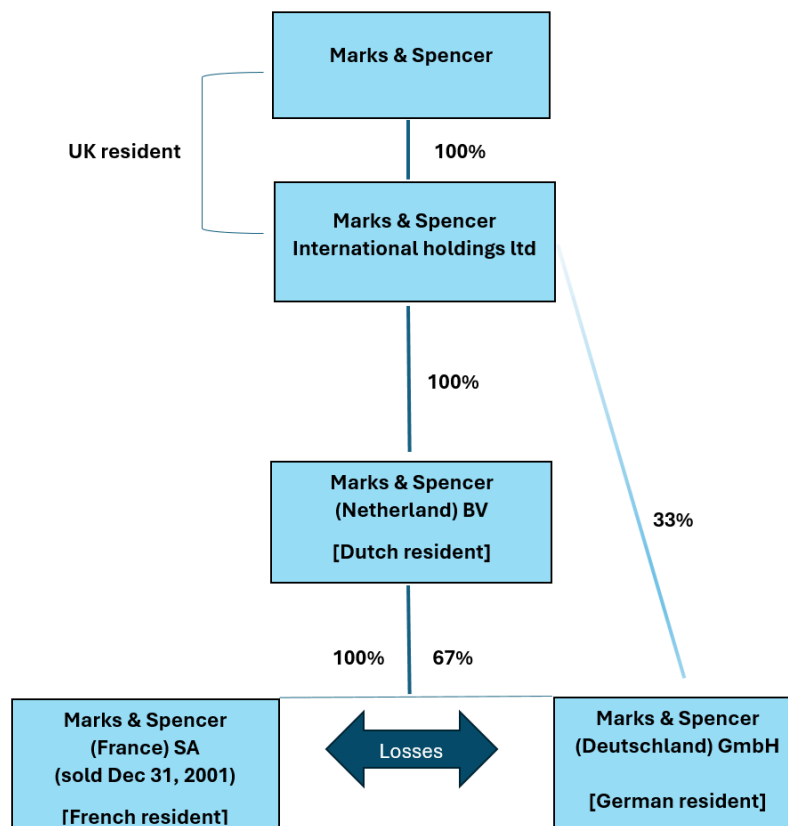
The Court also dismissed the “fiscal cohesion” justification invoked by the United Kingdom as, in its view, there was no direct link between the consortium relief granted for losses incurred by a resident subsidiary and the taxation of profits made by nonresident subsidiaries.

Seven years later, a similar issue was decided by the CJEU in *Marks & Spencer*.¹⁷⁴

The case involved Marks & Spencer plc, a U.K. resident company that held several continental European subsidiaries that had become loss-making during the 1990s.

¹⁷³ Case C-264/98, *Imperial Chemical Industries*.

¹⁷⁴ Case C-446/03, *Marks & Spencer*.



Marks & Spencer sought to offset these losses against its U.K. profits.

Under the prevailing U.K. tax rules, however, group relief was only available to U.K. resident companies or to nonresident companies carrying on a trade in the United Kingdom through a PE.

Marks & Spencer was, therefore, denied the requested cross-border group relief.

According to the CJEU, this constituted a restriction on the freedom of establishment.

The Court, however, accepted that the restriction at issue was justifiable under a combined application of:

- (i) The need to preserve a balanced allocation of taxing powers;
- (ii) The need to prevent losses from being used twice; and
- (iii) The need to prevent the risk of tax avoidance.

According to the Court:

“[i]n the light of those three justifications, taken together, it must be observed that restrictive provisions such as those at issue in the main proceedings pursue legitimate objectives which are compatible with the Treaty and constitute overriding reasons in the public interest and that they are apt to ensure the attainment of those objectives.”

Nonetheless, when assessing the proportionality of the outright denial of cross-border group relief, the CJEU held that allowing for the compensation of “final losses,” i.e., losses that had become exhausted in the subsidiaries’ Member States, would make the United Kingdom’s group relief regime less restrictive.

Consequently, the CJEU concluded that, as EU law then stood (and continues to stand), the freedom of establishment did not preclude provisions of a Member State that generally prevented a resident parent company from deducting from its taxable profits losses incurred in another Member State by a subsidiary established in that Member State although it allowed it to deduct losses incurred by a resident subsidiary.

However, according to the Court, it was contrary to that freedom to prevent the resident parent company from doing so where:

- (i) The nonresident subsidiary had exhausted the possibilities available in its State of residence of having the losses taken into account for the accounting period that the claim for relief concerned and also for previous accounting periods; and
- (ii) There was no possibility of those losses being taken into account in its State of residence for future periods either by the subsidiary itself or by a third party, in particular where the subsidiary had been sold to that third party.

Comment: In other words, if the “no possibilities” test is fulfilled, the freedom of establishment prevails over a given allocation of taxing powers, provided the exercise of the taxing powers places a disproportionate burden on the exercise of that freedom.

On the other hand, it appears implicit in the CJEU’s decision that the burden of proof as regards the fulfillment of the “no possibilities” condition lies with the taxpayer (which raises

the question of whether this could in itself result in an indirect restriction if the criteria set for meeting that burden of proof are almost impossible to meet in practice). Unsurprisingly, the reasoning in *Marks & Spencer* was a shock for the tax community (which saw the decision as politically driven) and was welcomed by some governments.

A similar line of reasoning was followed in *Lidl Belgium*,¹⁷⁵ a case sometimes labelled as “*Marks & Spencer* revisited on the branch level.” The Court referred to the “no possibilities” test by pointing out that Lidl Belgium had not shown that the conditions of that test were fulfilled (incidentally, as was confirmed at the hearing before the Court, Lidl Belgium had in fact benefited from such an offset of the losses incurred by its PE in 1999 in a subsequent tax year (2003) in which that entity generated profits).

In 2013, the CJEU confirmed its endorsement of the “no possibilities” test in *A Oy*,¹⁷⁶ a case that concerned a Swedish transferring company that had merged into a Finnish receiving company, *A Oy*.

The Swedish company had carried-forward losses, but no longer conducted any business activities in Sweden.

A Oy asked the Finnish tax authorities to allow for compensation of the Swedish losses against its Finnish profits.

Under the Finnish tax rules, however, the transfer of losses to a receiving company was only possible in the context of a purely domestic merger.

The CJEU held that national legislation under which a parent company merging with a subsidiary established in another Member State that had ceased activity could not deduct from its taxable income the losses incurred by that subsidiary with respect to the tax years prior to the merger, while that legislation allowed such a possibility when the merger was with a resident subsidiary, was incompatible with EU law if it did not allow the parent company the possibility of demonstrating that its nonresident subsidiary had exhausted all the possibilities of taking those losses into account and that there was no possibility of their being taken into account in its State of residence for future tax years, either by itself or by a third party.

In *Commission v. United Kingdom*,¹⁷⁷ the CJEU (re)confirmed its “no possibilities” test.

Interestingly enough, the Court did not address in any way the suggestion that Advocate General Kokott had expressed in her opinion, namely that this test had to be abandoned altogether (see paragraphs 50–53 of the opinion).

Instead, the Court specified that, under the *Marks & Spencer* case law, the losses incurred by a nonresident subsidiary might be characterized as definitive only if that subsidiary no longer had any income in its Member State of residence, implying that, as long as that subsidiary continued to be in receipt of even minimal income, there was a possibility that the losses sustained might yet be offset by future profits made in the Member State in which it was resident.

¹⁷⁵ Case C-414/06, *Lidl Belgium*.

¹⁷⁶ Case C-123/11, *A Oy*.

¹⁷⁷ Case C-172/13, *Commission v. United Kingdom*.

In *Bevola*,¹⁷⁸ the CJEU further emphasized that the *Marks & Spencer* case law — which it thus deemed still relevant — might be applied by analogy to the losses of nonresident PEs.

Hence, according to the Court, losses attributable to a non-resident PE became definitive when:

- (i) The company possessing the establishment had exhausted all the possibilities of deducting those losses available under the law of the Member State in which the establishment was situated; and
- (ii) It had ceased to receive any income from that establishment, so that there was no longer any possibility of the losses being taken into account in that Member State.

A variation on the same theme may be found in *W AG*,¹⁷⁹ in which the CJEU held that Articles 49 and 54 of the TFEU had to be interpreted as not precluding a tax system of a Member State under which a resident company could not deduct from its taxable profits the final losses incurred by its PE situated in another Member State when the Member State of residence had waived its power to tax the profits of that PE under a tax treaty.¹⁸⁰

The Court added that this conclusion was not called into question by the judgment in *Bevola*.

In *Bevola*, the Member State of residence of the company that requested that the final losses incurred by its nonresident PE be taken into account had not waived its power to tax the PE's profits under a tax treaty.

Instead, it had decided *unilaterally* not to take into account the profits made and losses incurred by nonresident PEs of resident companies.

In *W AG*, however, the Member State of residence waived its power to tax profits made by PEs situated in another Member State under a tax treaty concluded between the two Member States concerned.

The same consideration applies, symmetrically, to the taking into account of losses recorded by such PEs.

According to the CJEU, a distinction is to be made as to whether the exclusion of final losses in the Member State of residence is based on a national rule or a bilateral agreement (tax treaty).

¹⁷⁸Case 650/16, *Bevola*. The case concerned the situation in which a Member State (Denmark) did not exercise its tax jurisdiction over a resident company with a foreign PE of which the activities were being ceased and a non-deductible loss remained in the source State. The Court confirmed that nonresident subsidiaries with domestic PEs and resident subsidiaries with domestic PEs are in comparable situations when there is no other possibility of deducting the losses of the nonresident subsidiary attributable to the PE that is resident in the Member State in which the subsidiary is established (see also, Case C-28/17, *NN A/S v Skatteministeriet*).

¹⁷⁹Case C-538/20, *W AG*. A similar approach seems to be followed by the French Supreme Administrative Court (*Conseil d'État*) in its decision of April 26, 2024 in case n° 466062, *Financière SPIE Batignolles*, paras. 11 and 12. The French Court, explicitly referring to *W AG*, stated that different tax treatments do not breach the freedom of establishment where the situations concerned are not objectively comparable: in the case at hand, France and Luxembourg did not treat domestic and foreign PEs in the same way under the terms of the France-Luxembourg tax treaty, which rendered the situations not objectively comparable. Consequently, the French Court concluded that the inability to offset Luxembourg PE losses did not restrict the freedom of establishment. The French Court did not send a request for a preliminary ruling to the CJEU.

¹⁸⁰See, by analogy, Case C-388/14, *Timac Agro Deutschland* and Case C-48/13, *Nordea Bank Danmark* (discussed at 4.a., above).

Comment (1): While not addressed in the CJEU's ruling, the conclusion would likely be different in the case of a treaty override under a domestic law provision containing a switch-over or subject-to-tax clause denying the tax treaty exemption.

Comment (2): According to Opinion Statement ECJ-TF 4/2022 of September 22, 2022, prepared by the CFE ECJ Task Force,¹⁸¹ the *W AG* decision made it clear that comparability should be examined differently depending on whether the exemption was granted by domestic or tax treaty law.

The CFE ECJ Task Force had reservations regarding this distinction. For the taxpayer, exemption had the same economic effects regardless of whether it derived from domestic law or tax treaty law.

Moreover, in the CFE ECJ Task Force's opinion, *W AG* departed from the Court's reasoning and thinking in *Lidl Belgium*, which also concerned Germany and the same rules.

The CFE ECJ Task Force concluded that it remained to be seen if *Marks and Spencer* was still "good law" or if *W AG* was one of the (final) nails in the coffin of the "final loss" doctrine. See also the *Holmen* and *Memira Holding* decisions discussed below.

Unlike the situation in *Bevola* (see above), which concerned losses attributable to a nonresident PE that had ceased activity and could no longer be deducted from the company's taxable profits in the Member State concerned, the situation in *Aures Holdings*¹⁸² involved a company transferring its tax residence to another Member State, but seeking to deduct in that other State a loss incurred when it had fallen exclusively under the tax jurisdiction of the previous Member State.

In the CJEU's analysis, a company that was tax resident of the same Member State, both when losses are incurred and when they are used, was not comparable to a company which incurred tax losses in one Member State and subsequently transferred its tax residence to another Member State.

In the latter case, the Member State where the use of the losses was claimed lacked taxing jurisdiction over the losses that had been incurred in a different Member State and there was a risk that the losses might be taken into account twice.

In other words, the Court held that resident companies with losses in one Member State, and companies which transferred their tax residence to that Member State and had incurred a loss in another Member State in respect of a tax year during which they were tax residents in the latter Member State, were not in a comparable situation in the light of the objectives of preserving the allocation of the power to impose taxes between the Member States and preventing the double deduction of losses.

The Court further emphasized that such conclusion held true even if the losses were final pursuant to the decision in *Bevola*.

In contrast to *Bevola*, in the case at issue, the (new) State of residence of the company did not have taxing jurisdiction over the losses that were accrued while the company had been subject to the taxing jurisdiction of another Member State.

¹⁸¹https://taxadviserseurope.org/new_agency/wp-content/uploads/2022/12/ECJ-TF-4-2022_W-AG.pdf.

¹⁸²Case C-405/18, *Aures Holdings*.

This conclusion also appears to be consistent with the *National Grid Indus* case law following which the freedom of establishment did not oblige the new Member State of residence to take into account losses which, having been realized in another Member State, fell outside its tax jurisdiction.

As suggested by Advocate General Kokott in her Opinion, taking into account the contentious nature of the concept of “final losses” within the meaning of *Marks and Spencer*, there would thus seem to be no need to extend the principle further.

In *Holmen*,¹⁸³ the CJEU ruled that the concept of “final losses” within the meaning of *Marks and Spencer* did not apply to the losses of a sub-subsidiary, unless all intermediate group companies applying for group relief and the sub-subsidiary sustaining losses that might be regarded as final were established in the same Member State.

To allow the parent company to use the sub-subsidiary’s losses where the intermediate companies and the sub-subsidiary were not resident in the same Member State could lead to group tax rate optimization strategies and, therefore, it would not be disproportionate for the Member State of the parent company to deny the use of such losses.

The Court added that it was the responsibility of the parent company to provide evidence that it was impossible for the losses to be used by a third party and that the subsidiary had exhausted all possibilities of using the losses in its own State of residence.

*Memira Holding*¹⁸⁴ was a case where a Swedish parent company absorbed its German subsidiary in a cross-border merger and where neither Swedish tax law nor German tax law allowed the pre-merger losses of the German subsidiary to be used by the Swedish parent.

The CJEU, referring to its judgment in *Holmen*, held that the German losses were not “final” as there existed, economically speaking, the possibility of an “indirect” deduction of the losses had the subsidiary been sold to a third party at a price reflecting the availability of the losses.

Therefore, according to the Court, losses were not “final” where a third party might take into account, for tax purposes, the losses of the subsidiary in that subsidiary’s State of establishment, such as following a sale of that subsidiary, for a price including the tax advantage represented by the deductibility of losses in the future.

Both the *Holmen* and *Memira Holding* decisions are of interest in that they further nuance the scope of the “no possibilities” test set forth in *Marks and Spencer*.

*Oy AA*¹⁸⁵ concerned the Finnish group contribution regime, a regime essentially based on a mechanism that is the reverse of that employed by the U.K. group relief system.

The Finnish group contribution regime operated via a mechanism under which:

- A contribution (profit) from a profit-making group company was transferred to a group company that had losses;
- The group contributions were considered as:

- Tax-deductible expenses of the contributing company; and
- Taxable income of the recipient company.

Oy AA was a (profitable) company resident in Finland that was 100% indirectly owned by *AA Limited*, a company resident in the United Kingdom that was loss-making.

Oy AA transferred profits to *AA Limited* and claimed a corresponding tax deduction under the Finnish group contribution regime.

However, the Finnish tax authorities denied the deduction on the basis that *AA Limited* was a nonresident company.

The Court decided that the different treatment of two subsidiaries resident in Finland:

- The subsidiary with a Finnish-resident parent company; and
- The subsidiary with a non-Finnish-resident parent company,

constituted a restriction on the freedom of establishment because the subsidiaries might be considered to be in a comparable situation.

However, taking into account the combination of:

- (i) The need to safeguard the balanced allocation of the power to tax between the Member States; and
- (ii) The need to prevent tax avoidance,

the CJEU found that a system that granted a subsidiary the right to deduct a financial transfer in favor of its parent from its taxable income only where the parent and the subsidiary both had their principal establishment in the same Member State:

- (i) Pursued legitimate objectives compatible with the Treaty and justified by overriding reasons in the public interest; and
- (ii) Was appropriate to ensuring the attainment of those objectives.

Moreover, as regards proportionality, the CJEU noted that the objectives of safeguarding the balanced allocation of the power to impose taxes between Member States and the prevention of tax avoidance were linked.

This was because the creation of wholly artificial arrangements that did not reflect economic reality, with a view to escaping the tax normally due on the profits generated by activities carried out in the national territory, was such as to undermine the right of the Member States to exercise their tax jurisdiction in relation to those activities and jeopardized a balanced allocation between Member States of the power to impose taxes.

According to the Court, even if the legislation at issue was not specifically designed to exclude from the tax advantage, it conferred purely artificial arrangements that were devoid of economic reality and created with the aim of escaping the tax normally due on the profits generated by activities carried out in the national territory, such legislation might nevertheless be regarded as proportionate to the objectives pursued, taken as a whole.

Finally, the CJEU pointed out that in a situation in which the advantage in question consisted of the possibility of making a transfer of income, thereby excluding such income from the

¹⁸³ Case C-608/17, *Holmen*.

¹⁸⁴ Case C-607/17, *Memira Holding*.

¹⁸⁵ Case C-231/05, *Oy AA*.

taxable income of the transferor and including it in the taxable income of the transferee, any extension of that advantage to cross-border situations would have had the effect of allowing groups of companies to choose freely the Member State in which their profits would be taxed.

This would be detrimental to the right of the Member State of the subsidiary to tax profits generated by activities carried out in its territory.

That detriment could not be prevented by imposing conditions concerning:

(i) The treatment of the income arising from the intra-group financial transfer in the Member State of the transferee; or

(ii) The existence of losses made by the transferee,

because it would also mean that, in the final analysis, the choice of the Member State of taxation would be a matter for the group of companies.

In other words, in the CJEU's view, there were no less restrictive measures that could have been applied to ensure that the balanced allocation of taxing powers would not be jeopardized and to eliminate the risk of tax avoidance.

In *Philips Electronics*,¹⁸⁶ yet another case concerning the U.K. group relief provisions, the key issue was whether losses incurred by a U.K. PE of a Dutch group company could be set off against the profits of a different U.K. company (belonging to the same group), using the system of group relief.

Although the transfer of losses would, subject to certain conditions, have typically been possible in similar circumstances, in this case the transfer was denied. One of the reasons for this was the fact that (as the law stood at the time) losses could also be claimed in the Netherlands.

According to the CJEU, the U.K. provisions at issue constituted a restriction on the freedom of establishment in that they imposed certain conditions on the possibility of transferring, through group relief and to a resident company, losses sustained by the PE of a nonresident company situated in that Member State, while the transfer of losses sustained in that Member State by a resident company was not subject to any equivalent condition.

The CJEU added that such a restriction was not justifiable based on the overriding reasons in the public interest relating to the objective of:

(i) Preventing the double use of losses;

(ii) Preserving a balanced allocation of the power to impose taxes between Member States; or

(iii) A combination of those two grounds.

This was, essentially, because the United Kingdom was not affected by the transfer of such losses since the losses had been incurred in its own territory — in contrast to the situation in *Marks & Spencer* (see above), which involved the cross-border movement of losses.

c. Tax Integration and Fiscal Unity

*Papillon*¹⁸⁷ concerned the (then applicable) French tax group rules providing a French group of companies with the right to an election allowing the ultimate parent of the group to take into account all of the profits and losses of the group companies and thus become the only corporation tax paying entity in the group.

Although the claimant, Société Papillon, made such an election, the election was rejected because the group structure included some French sub-subsidiaries that were held through a Dutch subsidiary and the French rules required all companies in the chain to be French taxpayers.

The CJEU pointed out that the French rules at issue were aimed at treating, to the extent possible, a group constituted by a parent company and its subsidiaries and sub-subsidiaries in the same way as an undertaking with a number of PEs, by allowing the results of each company to be consolidated.

Because that objective could be attained equally when:

(i) A parent company resident in a Member State held sub-subsidiaries also resident in that State through a subsidiary that was itself resident; and

(ii) A parent company resident in the same Member State held sub-subsidiaries that were also resident in that State, but held those sub-subsidiaries through a subsidiary established in another Member State,

those situations had to be considered to be objectively comparable.

Consequently, the tax regime at issue amounted to a restriction on the freedom of establishment, inasmuch as, from a tax perspective, it gave rise to unequal treatment based on the place of residence of the registered office of the subsidiary through which the resident parent company held its resident sub-subsidiaries and thus put structures involving EU subsidiaries in a disadvantageous position compared to structures involving purely domestic subsidiaries.

The CJEU rejected the following grounds of justification:

(i) The need to prevent losses being used twice; and

(ii) The risk of tax avoidance;

because, in the case at hand, the question of whether the profits and losses of companies belonging to the group should be taken into account arose only in relation to companies that were resident in a single Member State (i.e., the question did not concern the issue as to whether a nonresident subsidiary should be capable of falling within the group taxation regime).

For the same reason, the restriction could, in the Court's view, not be justified by the allocation of the power to impose taxes between Member States.

However, the CJEU held that the restriction was justifiable based on the need to ensure the coherence of the tax system. The reasoning of the Court was that the French tax integration regime at issue provided for the tax consolidation of companies and, to offset this, for the neutralization of certain transactions between the group companies to prevent, among other issues,

¹⁸⁶ Case C-18/11, *Philips Electronics*.

¹⁸⁷ Case C-419/07, *Papillon*.

the use of losses twice at the level of resident companies falling within the tax integration regime.

In the case of losses recorded by a sub-subsidiary, the subsidiary would generally provide for the depreciation of its holding in that sub-subsidiary and the parent company would, as a result, provide for the depreciation of its holding in the subsidiary.

Since those circumstances involved one and the same loss, originating at the level of the sub-subsidiary, where each of those companies was subject to the tax integration regime, the neutralization mechanism resulted in the provision for depreciation made by the parent company and the subsidiary being disregarded.

However, should the subsidiary be a nonresident company, the losses recorded by the sub-subsidiary would be taken into account twice:

- (i) Firstly, in the form of the direct losses of that sub-subsidiary; and
- (ii) Secondly, in the form of a provision made by the parent company for the depreciation of its holding in that subsidiary.

The internal transactions would not be neutralized because a nonresident subsidiary was not subject to the tax integration regime. As a result, the direct link that existed under the tax integration regime between the tax advantages and the neutralization of intra-group transactions would be eliminated, thereby affecting the coherence of the regime.

Eventually, however, the Court rejected the fiscal coherence defense for proportionality reasons, as the French legislation at issue prevented resident companies holding resident sub-subsidiaries through subsidiaries that were resident in another Member State from proving that there was no risk of losses being used twice under the tax integration regime.

In *X Holding*,¹⁸⁸ a Dutch resident parent company sought to form a fiscal unity with its loss-making Belgian resident subsidiary.

However, under the Dutch fiscal unity regime, only Dutch resident companies and nonresident taxpayers having PEs in the Netherlands were eligible to enter into a tax consolidation.

The CJEU found the regime to be incompatible with the freedom of establishment, holding that:

- (i) The situation of a resident parent company wishing to form a single tax entity with a resident subsidiary; and
- (ii) The situation of a resident parent company wishing to form a single tax entity with a nonresident subsidiary

were objectively comparable with regard to the objective of a tax scheme such as that at issue in the main proceedings, insofar as each sought to benefit from the advantages of that scheme, which, in particular, allowed the profits and losses of the companies constituting the single tax entity to be consolidated at the level of the parent company and the transactions carried out within the group to remain neutral for tax purposes.

However, in the CJEU's view, the regime was justified (and proportionate) in the view of the need to safeguard the

allocation of the power to impose taxes between the Member States.

Since the parent company was at liberty to decide to form a tax entity with its subsidiary and dissolve such an entity from one year to the next, the possibility of including a nonresident subsidiary in the single tax entity would be tantamount to granting the parent company the freedom to choose the tax scheme applicable to the losses of that subsidiary and the place where those losses are taken into account, thus allowing the parent company to choose freely the Member State in which the losses of the subsidiary were to be taken into account.

In *SCA Group Holding and Others*,¹⁸⁹ however, the CJEU held the Dutch fiscal unity rules to be in breach of the freedom of establishment because they did not allow the formation of:

- (i) A fiscal unity between a Dutch parent company and a Dutch sub-subsidiary held through an EU/EEA intermediate subsidiary; or
- (ii) A fiscal unity between two Dutch "sister" companies held through a joint EU/EEA parent company.

According to the Court, the rules created a difference in treatment since the ability to elect for the tax entity regime was dependent on whether the parent company held its indirect stakes through a subsidiary established in the Netherlands or in another Member State (in line with the decision in *Papillon*, discussed above).

An analogous difference in treatment existed where resident sub-subsidiaries could not be integrated into a tax entity with the resident parent company because both the intermediate subsidiary and the intermediate sub-subsidiary were established in another Member State.¹⁹⁰

Finally, the legislation at issue also created a difference in treatment between:

- (i) A parent company whose seat was in the Netherlands, which, thanks to the single tax entity regime could, for example, in determining its taxable profit, immediately set off the losses of its loss-making subsidiaries against the profits of its profit-making subsidiaries; and
- (ii) A parent company that also owned subsidiaries in the Netherlands but had its seat in another Member State and did not have a PE in the Netherlands, which was excluded from benefitting from the single tax entity regime and, therefore, from the cash-flow advantage that the regime bestowed.¹⁹¹

In *SCA* and *MSA Nederland BV*,¹⁹² the CJEU referred to the Dutch participation exemption under which profits or losses resulting from the possession, acquisition or disposal of a holding were not taken into account when determining the taxable profit of a tax entity.

It was, therefore, through this general exemption, and not through specific provisions for the neutralization of certain transactions (as was the case in *Papillon*), that the Dutch tax

¹⁸⁸ Case C-337/08, *X Holding*.

¹⁸⁹ Joined Cases C-39/13, C-40/13 and C-41/13, *SCA Holding Group and Others*.

¹⁹⁰ Case C-39/13, *SCA*.

¹⁹¹ Case C-40, *Inspecteur van de Belastingdienst Amsterdam*.

¹⁹² Case C-41/13, *MSA Nederland BV*.

system sought to prevent the double use of losses within a tax entity.

Accordingly, no direct link could be established between the granting of the tax advantage linked to the formation of a tax entity and the offsetting of that advantage by a particular tax. Consequently, the restriction on freedom of establishment resulting from the national legislation could not be regarded as justified by an overriding reason in the public interest based on preserving the coherence of the tax system.

The CJEU also rejected the justification on the ground of the risk of tax avoidance, reiterating its settled case law that that ground did not, by itself, constitute an autonomous justification for a tax restriction on freedom of establishment if it was not relied on in conjunction with a specific objective of combatting wholly artificial arrangements that did not reflect economic reality and whose purpose was to escape the tax normally due.

In *Inspecteur van de Belastingdienst Amsterdam*, which related to a fiscal unity between Dutch “sister” companies, the CJEU concluded that the objective of the tax entity regime at issue, which was to allow companies in the same group to be regarded for tax purposes as if they constituted one and the same taxpayer, could be achieved both by groups whose parent company was Dutch-resident and groups whose parent company was not Dutch-resident, at least insofar as this concerned solely the taxation of the sister companies subject to tax in the Netherlands.

The difference in treatment, as regards the possibility of fiscally integrating sister companies, was therefore justified neither by an objective difference of situation, nor by an overriding reason in the public interest based on the coherence of the tax system, related to the prevention of the double use of losses.

Building on its decision in *X Holding*,¹⁹³ in *Groupe Steria*,¹⁹⁴ the CJEU found the French consolidation rules providing for a full exemption of dividends between members of a “tax-integrated group” (i.e., a fiscal unity), while (as French law did not allow the formation of a fiscal unity in cross-border situations) dividends received from companies outside of a tax group (such as EU subsidiaries) were only 95% exempt, to be non-compliant with the freedom of establishment (and the free movement of capital).

This is commonly referred to as the “per element” approach, i.e., taxpayers, despite being unable to enter into a fiscal unity with subsidiaries established elsewhere in the EU, are nevertheless eligible for benefits from separate elements of the fiscal unity regime as if a fiscal unity with foreign subsidiaries could be entered into.

In sum, under the *Groupe Steria* doctrine and the “per element” approach adopted in that case, cross-border company structures could not be automatically excluded from all benefits of group taxation regimes.

Instead, generally, a case-by-case assessment must be undertaken.

In *Manitou BF SA* and *Bricolage Investissement France SA*,¹⁹⁵ the plaintiffs were two French companies that received

cross-border dividends from their EU subsidiaries and were subject to the 5% add-back into their profits.

As opposed to the facts in the *Groupe Steria* case, where the French company had formed a tax-integrated group with its domestic subsidiaries, neither of the plaintiffs had elected to form such a group with their subsidiaries, despite being eligible for the tax integration scheme.

In both cases, the neutralization was denied by the French tax authorities on the grounds that the French parent companies had decided not to opt for the tax integration scheme.

The CJEU held that, in light of the *Groupe Steria* ruling, Article 49 of the TFEU had to be interpreted as precluding legislation of a Member State relating to a tax integration scheme under which:

- (i) A resident parent company that had opted for tax integration with resident companies was entitled to neutralization as regards the add-back of a proportion of costs and expenses, fixed at 5% of the net amount of the dividends received by it from its subsidiaries located in other Member States that, had they been resident, would have been eligible in practice, if they so elected; but
- (ii) A resident parent company that had not opted for such tax integration despite the existence of capital links with other resident companies permitting it was refused such neutralization.

The Court also recalled that, with respect to neutralizing the add-back for dividends received, the situation of companies in a tax-integrated group was comparable to that of companies that were not part of a tax-integrated group. This was due to the fact that in each case the parent company bore the costs and expenses related to its shareholding in the subsidiary, and the profits made by the subsidiary and from which the dividends distributed were derived could be, in principle, subject to economic double taxation or to a series of charges to tax.

The CJEU thus extended the *Groupe Steria* doctrine to French parent companies which had not opted (under the then applicable French rules) for the constitution of a French consolidated tax group.

In *X and X*,¹⁹⁶ the CJEU confirmed that the “per element” approach was also applicable to the Dutch fiscal unity regime.

At issue was a provision of the Dutch Corporate Income Tax Act disallowing the deduction of interest paid on a debt to an affiliated party whereby the debt was used to fund the following “tainted transactions:”

- (i) A capital contribution;
- (ii) A dividend distribution; or
- (iii) An acquisition of a participation,

depending on the business motives for the transaction and the way in which the loan was structured.

However, such tainted transactions were usually invisible if they occurred within a Dutch fiscal unity, as a result of which the application of the provision at issue could generally be avoided in domestic situations. Since the benefits of the Dutch

¹⁹³ Case C-337/08, *X Holding* (see the discussion, above).

¹⁹⁴ Case C-386/14, *Groupe Steria*.

¹⁹⁵ Joined Cases C-407/22, *Manitou BF SA* and C-408/22, *Bricolage Investissement France SA*.

¹⁹⁶ Joined Cases C-398/16, *X* and 399/16, *X*.

fiscal unity regime were limited to Dutch tax resident entities, such benefits could not be obtained in cross-border situations, which the CJEU considered to amount to a (non-justifiable) restriction to the freedom of establishment.

d. Controlled Foreign Company Regimes

CFC regimes are used in many countries as a means of preventing the erosion of the domestic tax base and discouraging residents from shifting income to jurisdictions that do not impose tax or that impose tax at low rates. While the rules applicable to CFCs and the attributes of a CFC differ from country to country, the hallmark of CFC regimes in general is that they eliminate the deferral of income earned by a CFC and tax residents currently on their proportionate share of a CFC's income.

Typical conditions for the application of such regimes are as follows:

- (i) A domestic taxpayer must “control” the CFC;
- (ii) The CFC must be located in a “low tax” jurisdiction or a jurisdiction that imposes tax at a rate lower than the rate (as specifically defined) in the shareholder's country of residence or, alternatively, the CFC must be located in a “black” or “grey” list jurisdiction (as opposed to the favored “white” list jurisdiction); and
- (iii) The CFC must derive specific types of income (for example, income from passive assets (such as holdings of bonds or portfolio equity, ownership of acquired patent rights, and lending to other affiliated corporations) in some regimes, but all types of income in others).

In *Cadbury-Schweppes*,¹⁹⁷ the CJEU had to evaluate the case of a U.K. group of companies that had established two subsidiaries in Ireland.

In 1996, one of these subsidiaries had received significant amounts of income from passive assets and the U.K. tax authorities in 2000 decided that, based on the U.K. CFC rules, U.K. tax had to be paid by the U.K. parent.

The CJEU decided that the U.K. CFC rules constituted discrimination and a restriction on the freedom of establishment.

Had the U.K. parent set up a subsidiary in the United Kingdom (rather than in Ireland), the parent would not have been taxed on the income of the subsidiary.

However, the Irish subsidiary was taxed under the U.K. CFC rules.

The fact that the effective taxation of the Irish profits was not raised above the level that applied in the case of a U.K. subsidiary company did not change the view of the CJEU, as the fact remained that, under such legislation, the resident company was taxed on profits of another legal person, a situation that did not occur in the case of a U.K. subsidiary.

In the absence of overriding reasons of public interest, the CJEU held that the restriction could not be justified by the objective of preventing the Irish subsidiary taking advantage of the lower tax rate in Ireland. A restriction could only be justified by the objective of preventing the creation of a wholly

artificial arrangement that reflected not economic reality but a pure tax avoidance motive (e.g., a pure letterbox entity). Unless such a case could be proven, the CJEU decided that taxation based on CFC legislation was an infringement on the freedom of establishment.

*Columbus Container Services*¹⁹⁸ concerned German provisions replacing the exemption method established by a bilateral tax treaty with a credit method with respect to the low-taxed passive foreign PE income of a partnership.

The CJEU held the concerned provisions to be compatible with the freedom of establishment as the German “switch-over” clause made no distinction between the taxation of income from a domestic partnership and income from a partnership residing in a different Member State.

Using this vertical analysis (the “migrant/non-migrant test,” as described in *Kerckhaert-Morres*),¹⁹⁹ the CJEU declined to apply the horizontal approach, which had been suggested in the opinion rendered by Advocate General Mengozzi and according to which national measures, such as those addressed in *Columbus Container Services*, should be regarded as having the effect of fragmenting the common market by encouraging German nationals to establish themselves only in Member States where the level of taxation was equal to or above the German rate provided for under applicable German tax legislation.²⁰⁰

Comment: From this angle, in the view of some, the question arises whether the decision is compatible with *Cadbury Schweppes*, which, according to those authors, seems to have admitted that the freedom of establishment may also be infringed in cases of horizontal discrimination.²⁰¹

¹⁹⁸ Case C-298/05, *Columbus Container Services*.

¹⁹⁹ Case C-513/04, *Kerckhaert-Morres*. The “migrant/non-migrant test” is an application of the national treatment principle in the origin Member State — the origin Member State is obliged to respect the principle of national treatment of nationals of other Member States and of their own nationals who exercise the freedoms guaranteed by the TFEU.

²⁰⁰ The horizontal test identifies a restriction by comparing cross-border investments in a given Member State with cross-border investments in another Member State. Advocate General Mengozzi maintained that the German “switch-over” rule represents an unjustified restriction of both the freedom of establishment and the freedom of capital movement. He based his conclusion on the fact that the rule treats foreign establishments in two or more EU Member States differently, depending on whether the establishment concerned is low-taxed.

²⁰¹ In her opinion in Case C-512/13, *Sopora*, Advocate-General Kokott stresses that with regard to the question of whether the fundamental freedoms also prohibit differentiation between nationals of different Member States, the CJEU has up to now given varying signals: on the one hand, it has rejected the view that unequal treatment depending on the Member State of establishment alone constitutes an impairment of the freedom of establishment under TFEU, Art. 49 (Case C-298/05, *Columbus Container Services*) and, with regard to free movement of capital under TFEU, Art. 63(1), which also applies to third countries, the Court has not viewed the differing treatment of capital gains, depending on the third country in which they originate, as falling under the protection of that provision (Joined Cases C-436/08 and C-437/08, *Haribo*); on the other hand, also in the context of free movement of capital, the Court has found an impairment of the fundamental freedom by reason of the unequal treatment of various other Member States by the State of origin (Case C-194/06, *Orange European Smallcap Fund*). In other decisions, both in the context of the free movement of capital and in that of the freedom of establishment, the Court has at least examined whether the differing treatment of various nonresidents constitutes an impairment of the fundamental freedom in the specific case in question (see Case C-376/03, *D*, and Case C-374/04, *Test Claimants in Class IV of the ACT Group Litigation*). Thus, the position remains unclear.

¹⁹⁷ Case C-196/04, *Cadbury Schweppes*.

In *Test Claimants in the CFC and Dividend Group Litigation v. Commissioners of Inland Revenue (CFC GLO)*,²⁰² the CJEU reasserted the position it had adopted in *Cadbury Schweppes*.

In a reasoned order,²⁰³ the Court noted that national CFC rules might be justified if they specifically target wholly artificial arrangements designed to circumvent the legislation of the Member State concerned.

However, such tax measures could not be applied where it was proven, based on objective factors ascertainable by third parties, that, despite the existence of tax motives, the CFC concerned was actually established in the host Member State and carried on genuine economic activities there.

The Court further held that, where the legislation of a Member State made the granting of a tax advantage dependent on the meeting of requirements, compliance with which could be verified only by obtaining information from the competent authorities of a third country, it was, in principle, legitimate for that Member State to refuse to grant that advantage if, in particular because the third country was not under any contractual obligation to provide information, it proved impossible to obtain such information from that country.

Undoubtedly in the wake of this case law, a Council Resolution of June 8, 2010²⁰⁴ recommended that, when applying within the EU cross-border CFC rules that were not applicable in similar domestic situations, Member States be guided by a non-exhaustive list of indicators suggesting that profits might have been artificially diverted to a CFC.

These indicators include, in particular:

- (i) Insufficiently valid economic or commercial reasons for the profit attribution, which therefore does not reflect economic reality;
- (ii) The fact that incorporation does not essentially correspond to an actual establishment intended to carry on genuine economic activities;
- (iii) No proportionate correlation between the activities apparently carried on by the CFC and the extent to which it physically exists in terms of premises, staff and equipment;
- (iv) The fact that the nonresident company is overcapitalized (i.e., it has significantly more capital than it needs to carry on its activity); and
- (v) The fact that taxpayer has entered into arrangements that are devoid of economic reality and serve little or no business purpose, or that might be contrary to general business interests, if not entered into for the purposes of avoiding tax.

In the meantime, an express interest limitation rule has been embedded as an ATAD 1 measure (see VI.B.2., below).

²⁰² Case C-201/05, *Test Claimants in the CFC and Dividend Group Litigation v. Commissioners of Inland Revenue (CFC GLO)*.

²⁰³ A reasoned order is issued instead of a judgment when the Court has already ruled on an identical question.

²⁰⁴ Council Resolution of June 8, 2010 on coordination of the Controlled Foreign Corporation (CFC) and thin capitalization rules within the European Union (2010/C 156/01).

e. Thin Capitalization

In *Lankhorst-Hohorst*,²⁰⁵ the German thin capitalization rules were questioned in relation to the freedom of establishment.

Lankhorst-Hohorst GmbH, a limited liability company resident in Germany, was granted a loan accompanied by a letter of support from its ultimate parent, a company registered in the Netherlands.

The interest paid by *Lankhorst-Hohorst* was reclassified as a covert distribution of profits under German legislation and taxed at a rate of 30%.

The German legislation applicable at the time stated that repayments with respect to loan capital were to be regarded as covert distributions of profits if:

- (i) A company subject to unlimited taxation had obtained the loan concerned from a shareholder not entitled to a corporation tax credit; and
- (ii) The company's total debt:equity ratio exceeded 3:1, unless the company was able to demonstrate that the loan could have been obtained from a third party under otherwise similar circumstances.

These rules applied to nonresident shareholders and corporations governed by German law that were exempt from German corporation tax (i.e., essentially, legal persons governed by public law and those carrying on business in a specific field or performing tasks that it was desired to encourage), in contrast to the large majority of cases, in which resident parent companies were instead eligible for a tax credit.

The CJEU found this difference in treatment between resident subsidiary companies depending on the seat of their parent company to constitute an obstacle prohibited by Article 49 of the TFEU, in that the German tax measure in question made it less attractive for companies established in other Member States to exercise the freedom of establishment, it being possible that such companies might, in consequence, refrain from acquiring, creating or maintaining a subsidiary in the State adopting the measure.

In response to the argument that the national measure at issue was intended to combat tax evasion in the form of the use of "thin capitalization" or "hidden equity capitalization," the CJEU held:

- (i) First, that it was settled law that a reduction in tax revenue did not constitute an overriding reason in the public interest that might justify a measure that was in principle contrary to a fundamental freedom; and
- (ii) Second, as regards the justification based on the risk of tax evasion, the Court was of the view that the legislation at issue did not have the specific purpose of preventing a wholly artificial arrangement designed to circumvent German tax legislation from attracting a tax benefit, but applied generally to any situation in which a parent company had its seat, for whatever reason, outside Germany. Such a situation did not, of itself, entail a risk of tax evasion, since

²⁰⁵ Case C-324/00, *Lankhorst-Hohorst*.

such a company would in any event be subject to the tax legislation of the State in which it was established.

The CJEU also dismissed the justifications based on the need to ensure:

- (i) The coherence of the applicable tax systems; and
- (ii) The effectiveness of fiscal supervision.

*Test Claimants in the Thin Cap Group Litigation*²⁰⁶ concerned the recharacterization of interest as a dividend where the interest payment did not respect the arm's-length principle.

The claimants were British subsidiaries that had lent money to a subsidiary located in another Member State.

The pre-2004 U.K. thin capitalization rules re-characterized the interest payable by U.K. resident companies to certain non-U.K. resident related parties as a distribution, when the amount of the interest exceeded what would be payable on an arm's-length basis. In practice, this meant that such interest was not tax deductible.

Prior to the abolition of advance corporation tax (ACT) in 1999, it also meant that ACT had to be paid by the subsidiary on the re-characterized distribution.

A further complication to the test cases involved the third-country or nonmember State element, as some of the test claimants had parent companies resident in the United States or the loans were made by group companies or branches located in third countries.

In the case of all the test claimants, what was at issue was a group situation involving a U.K. resident company that was at least 75% owned, directly or indirectly, by a non-U.K. resident parent company.

The U.K. resident company had been granted a loan either by that parent company or by another non-U.K. resident company that was at least 75% owned, directly or indirectly, by that parent company.

The CJEU considered the matter in relation to the freedom of establishment since, in the Court's view, the U.K. thin capitalization rules were targeted only at relations within a group of companies, thus primarily affecting the freedom of establishment, with the implication being that any restrictions on the freedom to provide services or the free movement of capital had to be seen as an unavoidable consequence of any restriction on the freedom of establishment.

The CJEU found the U.K. rules to amount to a restriction on the freedom of establishment and dismissed justifications based on:

- (i) The allocation of fiscal powers;
- (ii) Fiscal cohesion; and
- (iii) The prevention of abusive practices.

However, the CJEU accepted the justification based on the need to counter abusive practices, holding that legislation of a Member State might be justified by the need to combat abusive practices where it provided that interest paid by a resident subsidiary to a nonresident parent company was to be treated as a distribution only if, and to the extent that, the interest exceeded what those companies would have agreed upon on an arm's-

length basis, i.e., the commercial terms that those parties would have accepted if they had not formed part of the same group of companies. However, for such legislation to remain compatible with the principle of proportionality, the following cumulative criteria had to be satisfied:

- (i) The legislation had to provide for a consideration of objective and verifiable elements that made it possible to identify the existence of a purely artificial arrangement entered into for tax reasons alone (for example, an arm's-length test) and had to allow taxpayers to produce, if appropriate and free of undue administrative constraints, evidence of the commercial justification for the transaction in question; and
- (ii) Where it was established that a purely artificial arrangement existed, the legislation had to treat the interest concerned as a distribution only to the extent it exceeded an arm's-length return.

See, in the same vein, *SGL*,²⁰⁷ *Hornbach-Baumarkt*,²⁰⁸ and *Lexel AB*,²⁰⁹ where the CJEU also confirmed that the arm's length standard served as a "safe harbor," i.e., if a transaction was at arm's length, it should never be considered as a wholly artificial arrangement.

This is particularly relevant in the context of the proportionality analysis of a Member State's tax measure.

For example, in *Lexel AB*,²¹⁰ which concerned a Swedish interest deduction limitation, the Court held that even where a transaction "represents a purely artificial arrangement without any underlying commercial justification, the principle of proportionality requires that the refusal of the right to a deduction should be limited to the proportion of that interest which exceeds what would have been agreed had the relationship between the parties been one at arm's length."

This position also follows, *a contrario*, from *X BV*,²¹¹ in which the CJEU held that where a loan is, in itself, devoid of economic justification and, but for the relationship between the contracting companies and the tax advantage sought, would never have been entered into, it is consistent with the principle of proportionality to deny a deduction for all the interest on the loan, since such a wholly artificial arrangement must be ignored by the tax authorities when calculating the corporate tax due. According to the Court, denying a deduct for only a fraction of the interest paid on the loan would allow the taxpayer to obtain a partial, or even the entire, tax advantage sought through abusive means, which would call into question the coherence of the anti-abuse regime.

*Lammers & Van Cleeff*²¹² concerned a Belgian statutory provision operating as a thin capitalization rule, under which interest payments (even if they exceeded one of the two applicable limits) were not reclassified as dividends, and were therefore not taxable, if those interest payments were made to a director that was a Belgian company. However, in the same circumstances, such interest payments were reclassified as divi-

²⁰⁶ Case C-524/04, *Test Claimants in the Thin Cap Group Litigation*.

²⁰⁷ Case C-311/08, *SGL*.

²⁰⁸ Case C-382/16, *Hornbach-Baumarkt*.

²⁰⁹ Case C-484/19, *Lexel AB*.

²¹⁰ Case C-484/19, *Lexel AB*.

²¹¹ Case C-585/22, *X BV*.

²¹² Case C-105/07, *Lammers & Van Cleeff*.

dends, and therefore taxable, if they were made to a director that was a foreign company.

The CJEU reiterated its holding in *Test Claimants in the Thin Cap Group Litigation* that legislation of a Member State might be justified by the need to combat abusive practices where it provided that interest paid by a resident subsidiary to a nonresident parent company was to be treated as a distribution only if, and to the extent that, it exceeded what those companies would have agreed upon on an arm's-length basis, i.e., the commercial terms that those parties would have accepted if they had not formed part of the same group of companies.

However, the Court concluded that the Belgian rule in question in any event went beyond what was necessary to attain such an objective.

At issue in *Itelcar*²¹³ was a Portuguese thin capitalization provision. The rule provided that, where interest attributable to the part of an overall debt categorized as excessive was paid by a resident company to a lending company established in a non-Member State with which the borrowing company had special relations, the interest was not deductible as an expense for the purposes of determining taxable profit.

However, where such interest was paid to a resident lending company with which the borrowing company had special relations, it was deductible for those purposes. Since the case involved a third country element, it was decided in relation to the free movement of capital.

The Court held that the Portuguese rule resulted in disadvantageous treatment that was liable to deter a resident company from entering into credit arrangements in a manner regarded as excessive with a company established in a nonmember country with which it has special relations. As such, this rule constituted a restriction on the free movement of capital. The CJEU further repeated that such a restriction might be justified where it specifically targeted wholly artificial arrangements that did not reflect economic reality and whose sole purpose was to avoid the tax normally payable on the profits generated by activities carried out in the national territory.

Nonetheless, the CJEU held the rule in question to be disproportionate as it did not make it possible, at the outset, to determine its scope with sufficient precision. It therefore did not meet the requirements of legal certainty, in accordance with which rules of law must be clear, precise; and predictable as regards their effects, especially where they may have unfavorable consequences for individuals and companies.

The Court concluded that rules that did not meet the requirements of the principle of legal certainty could not be considered to be proportionate to the objectives pursued.

While *Lankhorst-Hohorst* appeared to leave EU Member States with the option of:

- (i) Expanding their thin capitalization rules to include domestic companies;
- (ii) Limiting the scope of their rules to exclude domestic companies; or
- (iii) Entirely repealing their thin capitalization rules,

²¹³ Case C-282/12, *Itelcar*.

the CJEU's decision in *Itelcar* seems to have done away with option (ii), insofar as it suggested that applying thin capitalization rules only to non-EU countries was incompatible with EU law, specifically the free movement of capital principle.

In *Masco Denmark and Damixa*,²¹⁴ the CJEU found (contrary to the opinion issued by Advocate-General Kokott)²¹⁵ that Article 49 of the TFEU, read in conjunction with Article 54 of the TFEU, had to be interpreted as precluding legislation of a Member State (here: Denmark) that allowed a resident company a tax exemption for interest paid by a resident subsidiary, to the extent the subsidiary was not entitled to a tax deduction for the corresponding interest expenditure by reason of the rules limiting the deduction of interest paid in cases of thin capitalization, but that excluded the exemption that would result from the application of its own thin-capitalization legislation in the case where the subsidiary was resident in another Member State.

A Council Resolution of June 8, 2010²¹⁶ recommended that, when applying within the European Union cross-border thin capitalization rules not applicable in similar domestic situations, Member States be guided by a nonexhaustive list of indicators suggesting an artificial transfer of profits.

These indicators include, in particular, the fact that:

- (i) The level of debt to equity is excessive;
- (ii) The amount of net interest paid by the company exceeds a certain threshold by reference to the earnings before interest and taxes (EBIT) or of the earnings before interest, taxes, depreciation and amortization (EBITDA); and
- (iii) A comparison between the equity percentage of the company to that of the group worldwide appears to prove that the debt is excessive.

The Council Resolution further specified that:

- (i) Thin capitalization rules should respect the arm's-length principle; and
- (ii) Assessment under such rules must be made on a case-by-case basis.

In the meantime, an express CFC rule has been codified as an ATAD 1 measure (see VI.B.5., below).

f. Exit Taxes

In *de Lasteyrie du Saillant*,²¹⁷ the CJEU addressed the compatibility of exit taxes on individuals with the freedom of establishment in the context of French legislation taxing unrealized increases in the value of securities when individual taxpayers moved their tax residence outside France.

²¹⁴ Case C-93/14, *Masco Denmark and Damixa*.

²¹⁵ The Advocate General had concluded that there was no restriction of the freedom of establishment based on the principle of autonomy; she also argued that the difference in treatment at issue was in effect a disparity due to the combination of the Danish and German rules. By contrast, the Court concluded that the difference arose solely as a result of the Danish rules and in effect applied the principle derived from its earlier decision in Case C-319/02, *Manninen*.

²¹⁶ Council Resolution of June 8, 2010 on coordination of the Controlled Foreign Corporation (CFC) and thin capitalization rules within the European Union (2010/C 156/01).

²¹⁷ Case C-9/02, *de Lasteyrie du Saillant*.

On moving from France to Belgium in 1998, Mr. de Lasteyrie du Saillant was subject to immediate taxation on the unrealized increase in value of the shares that he held in a French company.

The CJEU held that the French provision in question was likely to restrict the exercise of the freedom of establishment, having at the very least a dissuasive effect on taxpayers wishing to establish themselves in another Member State, because they were subjected in the exit country, i.e., France, by the mere fact of transferring their tax residence outside France, to tax on a form of income that had not yet been realized, and thus to disadvantageous treatment by comparison with a person maintaining his/her residence in France.

In other words, the following amounted to a difference in treatment that constituted an obstacle to free movement:

- (i) Taxing residents on a realization basis; and
- (ii) Taxing departing residents on an accruals basis.

According to the Court, where a Member State decided to assert a right to tax gains accrued during a taxpayer's residence within its territory, it could not take measures that represented a restriction on free movement, thereby ruling out the possibility of the immediate collection of the tax due on unrealized gains when taxpayers moved their tax residence to another Member State.

Moreover, the CJEU held that making the possibility of deferring payment of the exit tax subject, for example, to conditions that guarantees had to be provided had a restrictive effect, in that the taxpayer was deprived of the enjoyment of the assets given as a guarantee.

Similarly, deferral of payment could not be made subject to the condition that a representative must be designated in the Member State of origin.

In general, any means of preserving the tax claim must be strictly proportional to that aim and must not entail disproportionate costs for the taxpayer.

In *N*,²¹⁸ a Dutch resident individual holding substantial interests in several Dutch companies had decided to move to the United Kingdom. At the same time, the companies' places of effective management had been transferred to the Netherlands Antilles.

N became liable, simply by reason of the transfer, to tax on income that he had not yet realized and that he therefore did not have.

However, if he had remained in the Netherlands, the increases in value would have become taxable only when, and to the extent that, they were actually realized.

Analogously to *de Lasteyrie du Saillant*, the CJEU confirmed that, when a resident of a Member State transferred his or her residence to another Member State, the Member State from which he or she departed was not prevented by EU law from assessing the amount of income over which it wished to preserve its tax jurisdiction, provided that:

- (i) This did not give rise to an immediate charge to tax; and
- (ii) There were no further conditions attached to the deferral of such charge.

The Court explained that such practice was in line with the principle of fiscal territoriality, connected with a temporal component, namely residence within the territory during the period in which the taxable profit arose.

A requirement that the taxpayer had to submit a tax declaration at the time of the transfer of his/her residence, which was necessary for the purposes of assessing the income and calculating the tax on the income, while constituting an administrative formality likely to hinder the exercise of fundamental freedoms by the person concerned or make such exercise less attractive, could nonetheless be considered proportionate having regard to the legitimate objective of allocating taxing powers, in particular, in order to eliminate double taxation, between the Member States.

Although it was possible not to determine the part of the tax going to the Member State of origin until after the event, i.e., the date of the actual disposal of the securities, that would involve obligations no less significant on the part of the taxpayer.

Apart from the tax declaration that the latter would have to submit to the relevant Dutch authorities at the time of the disposal of the securities, the taxpayer would have to keep all the documentary evidence for determining:

- (i) The market value of the securities at the time of his/her transfer of residence; and
- (ii) Any costs that might be deductible.

By contrast, a possible unjustified restriction could arise if the exit State calculated the capital gain at the moment of deemed disposal and collected the tax at the moment of actual disposal, and the new State of residence taxed the whole capital gain from acquisition up to actual disposal, as this would cause double taxation of the value increase from acquisition to deemed disposal, if the residence State considered that it had the exclusive taxing right with respect to the disposal and neither Member State granted a credit for the tax levied by the other.

*Commission v. Portugal*²¹⁹ concerned a Portuguese individual income tax provision under which a taxable person who transferred assets and liabilities related to an activity carried on an individual basis in exchange for shares of a company having its head office or its effective management in the territory of another Member State or a State belonging to the EEA.

However, such individual could not benefit from a deferral of taxation resulting from the transaction concerned.

The CJEU found this provision to be in (unjustifiable) breach of the freedom of establishment.

In a Communication of December 19, 2006, the Commission stated that the interpretation of the freedom of establishment given by the CJEU in *de Lasteyrie du Saillant* with respect to exit tax rules for individuals also had direct implications for Member States' exit tax rules for companies.²²⁰

²¹⁹ Case C-503/14, *Commission v. Portugal*.

²²⁰ Communication of December 19, 2006 from the Commission to the Council, the European Parliament and the European Economic and Social Committee, Exit taxation and the need for co-ordination of Member States' tax policies, COM (2006) 825 final.

²¹⁸ Case C-470/04, *N* (also referred to as the *van Dijk* case).

In response, in 2008, the Council issued a nonbinding resolution on the coordination of exit taxation.²²¹

After recalling that, because various tax jurisdictions co-existed within the European Union, the transfer of an economic activity that was subject to the tax system of a single tax jurisdiction was not treated in the same way as the transfer of an economic activity that was subject to the legislation of two or more tax jurisdictions, the Council Resolution invited the Member States to adopt the following guiding principles:

(i) When, in connection with a transfer of economic activities:

(a) The exit State reserved the option to exercise its taxing rights on the reserves made (profits realized but not yet taken into account for tax purposes) and to take back, in full or in part, the provisions made (expenditure not yet incurred but already taken into account for tax purposes);

(b) The host State might provide for the creation of reserves or provisions of identical or different amounts, in accordance with the rules governing the tax base in that State and might allow a deduction from taxable results for the year in which such reserves or provisions were established; and

(ii) When, in connection with a transfer of economic activities:

(a) The exit State reserved the option to exercise its taxing rights on the unrealized gains corresponding to the assets held by the taxpayer, calculated as the difference between the market value of the assets on the transfer date and their book value;

(b) The host State should use the market value on the transfer date when calculating the subsequent added value in the event of a disposal.

For these purposes, a “transfer of economic activities” was defined as any operation whereby a taxpayer subject to corporation tax or a natural person engaged in a business:

(i) Ceased to be subject to corporate or personal income tax in a Member State (the exit State) and, at the same time, became subject to corporate or personal income tax in another Member State (the host State); or

(ii) Transferred a combination of assets and liabilities from a head office or a PE in the exit State to a PE or a head office in the host State.

In the case of disagreement between the host State and the exit State regarding the market value of the assets on the transfer date, the two States should settle their dispute using the appropriate procedure.

(i) The host State could require a taxpayer engaged in a transfer of economic activities to provide:

(a) Evidence of the fact that the exit State had exercised or would exercise its rights in the terms set out above; and

(b) Evidence of the market value applied by the exit State.

(ii) In addition, the provisions laid down at the EU level in relation to Mutual Assistance provided the framework for the host State to assist the exit State, in particular, for the purposes of determining the disposal date.

The Council Resolution, however, was silent on the deferred taxation of unrealized gains.

It was not until 2011 and *National Grid Indus* (see below) that the CJEU extended the interpretation of the freedom of establishment given by it in *de Lasteyrie du Saillant* with respect to exit tax rules for individuals²²² to exit tax rules for companies. Even then, this extension was somewhat unexpected, given the CJEU’s earlier (company law) decisions in *Daily Mail*, *Cartesio* and *Vale*.

*Daily Mail*²²³ concerned Daily Mail and General Trust PLC (“Daily Mail”), a U.K. investment holding company that wished to:

(i) Sell a significant part of its portfolio investments; and

(ii) Use the proceeds of the sale to buy its own shares.

The proposed transaction would have made Daily Mail liable to a substantial capital gains tax charge in the United Kingdom.

With a view to avoiding this tax, Daily Mail envisaged transferring its place of central management and control, and thus its tax residence, to the Netherlands.

On arrival in the Netherlands, Daily Mail would have to file an opening balance sheet for tax purposes on which the portfolio investments would have to be recorded at their real market value.

As such, no capital gains would be recognized for Dutch corporate income tax purposes at the time of the subsequent sale.

An obstacle to implementing the transaction, however, was a provision of U.K. tax law making the proposed transfer of the corporate seat conditional on the obtaining of the prior consent of the U.K. Treasury.

The U.K. Treasury’s prior consent required Daily Mail, among other conditions, to:

• Sell at least part of the portfolio; and

• Pay capital gains tax before the relocation.

Daily Mail contended that the freedom of establishment gave it the right to transfer its central management and control to another Member State without prior consent or the right to obtain such consent unconditionally.

²²¹ Council Resolution on coordinating exit taxation, 2911th Economic and Financial Affairs, Brussels, December 2, 2008.

²²² With the exception of one paragraph, the entirety of the *de Lasteyrie du Saillant* judgment was written in terms of “taxpayer,” rather than referring merely to the taxation of individuals. See also Case C-411/03, *Sevic*, concerning a cross-border merger of companies, where the CJEU expressly cited *Lasteyrie du Saillant*. See also Communication of December 19, 2006 from the Commission to the Council, the European Parliament and the European Economic and Social Committee, Exit taxation and the need for co-ordination of Member States’ tax policies, COM (2006) 825 final, which states that the Commission is of the opinion that the interpretation of the freedom of establishment given by the CJEU in *de Lasteyrie du Saillant* with respect to exit tax rules for individuals also has direct implications for Member States’ exit tax rules for companies.

²²³ Case 81/87, *Daily Mail*.

The CJEU first reasoned that, while the freedom of establishment secured the right of establishment in another Member State not merely for EU nationals but also for companies, unlike natural persons, companies were creatures of national law that existed only by virtue of the different national legislations of the Member States, which varied widely, both with regard to:

- (i) The nexus with the national territory required for the incorporation of a company; and
- (ii) Whether, once incorporated under the legislation of a Member State, a company may subsequently modify that nexus.

The CJEU concluded that, in these circumstances, (now) Articles 49 and 54 of the TFEU could not be interpreted as conferring on companies incorporated under the law of a Member State and having their registered office there the right to transfer their central management and control to another Member State.²²⁴

The CJEU confirmed its *Daily Mail* judgment in *Cartesio*.²²⁵

In *Vale*,²²⁶ the Court focused on the freedom of the host State to place limits on companies that opted to relocate and convert into a legal form governed by the host State law.

On the other hand, based on *Überseering*,²²⁷ which concerned Germany's refusal to accept the legal capacity of a company incorporated under the laws of another Member State whose real seat was in Germany, it could possibly be argued that, for company law purposes, the freedom of establishment could apply in a case involving the transfer of a company's seat.²²⁸ The *Daily Mail* judgment was heavily criticized by tax

commentators who argued that the CJEU, in approaching the entire issue as merely a problem of international company law, had deliberately abstained from addressing the real question, which was a tax question, i.e., whether a Member State was permitted, under Article 49 of the TFEU, to require settlement of the tax position of an undertaking wishing to leave its (tax) jurisdiction to establish itself in another Member State.²²⁹

That question was eventually addressed in *National Grid Indus*.²³⁰

This case concerned National Grid Indus BV, a private limited liability company incorporated under the laws of the Netherlands that transferred its effective management from the Netherlands to the United Kingdom, while retaining its legal personality and status as a Dutch BV.

Because of the applicable tax treaty, this relocation triggered a transfer of the taxing power with respect to capital gains from the Netherlands to the United Kingdom.

While the relocation was permitted by Dutch company law (which followed the incorporation doctrine), an immediate exit tax on the exchange rate gain on an intragroup claim, being the only unrealized capital gain, was imposed as a consequence of the applicable Dutch tax laws.

Commencing with the *Daily Mail* interpretation, the CJEU first reiterated that, in the absence of a uniform definition in EU law of the companies that could enjoy the right of establishment based on a single connecting factor determining the national law applicable to a company, the question of whether Article 49 of the TFEU applied to a company seeking to rely on the fundamental freedom enshrined in that Article (like the question of whether a natural person was a national of a Member State and hence entitled to enjoy that freedom) was a preliminary matter that could only be resolved by the applicable national law.

Consequently, the question of whether the company was faced with a restriction on the freedom of establishment within the meaning of Article 49 of the TFEU could arise only if it had been established, in the light of the conditions laid down in Article 54 of the TFEU, that the company actually had a right to that freedom.

A Member State thus had the power to define both the connecting factor required of a company if it was to be:

- (i) Regarded as incorporated under its national law and, as such, capable of enjoying the right of establishment; and
- (ii) Able to maintain that status.

According to the Court, a Member State was therefore able, in the case of a company incorporated under its law, to make the company's right to retain its legal personality under the law of that State subject to restrictions on the transfer abroad of the company's place of effective management.

However, the national legislation at issue did not concern the determination of the conditions required by a Member State of a company incorporated under its law for that company to be able to retain its status as a company of that Member State

²²⁴ The CJEU's ruling departed from the opinion of Advocate General Darmon who had stated that the transfer to another Member State of the central management of a company constitutes "establishment" within the meaning of the Treaty, provided genuine economic activity exists in the State of origin. Arguably, the acceptance of this solution would have amounted to derogating, on fiscal grounds, from the freedom of establishment, justified under the rule of reason. Compare with Case C-411/03, *SEVIC Systems*, where the CJEU had to assess whether the freedom of establishment encompassed a form of establishment effected via a cross-border merger. The Court held that the *Daily Mail* decision did not come into play because the *SEVIC Systems* case involved, not so much the existence of a company (as was the case in *Daily Mail*), but its transformation within the framework of a single operation, to pursue a particular activity in new forms and without interruption. In other words, whereas *Daily Mail* concerned the conditions under which an entity may be regarded as existing pursuant to the law of a Member State, *SEVIC Systems* concerned the conditions under which an entity, the existence of which was not under discussion, may reorganize itself by way of a cross-border merger. The Court concluded that the latter situation is indeed protected by the freedom of establishment.

²²⁵ Case C-210/06, *Cartesio*.

²²⁶ Case C-378/10, *Vale*.

²²⁷ Case C-208/00, *Überseering*.

²²⁸ According to the CJEU, the difference between the facts in *Daily Mail* and those in *Überseering* was that *Daily Mail* concerned relations between a company and the Member State under whose laws it had been incorporated in a situation where the company wished to transfer its actual center of administration to another Member State while retaining its legal personality in the State of incorporation, whereas *Überseering* concerned the recognition by one Member State of a company incorporated under the law of another Member State, such a company being denied all legal capacity in the host Member State, which took the view that the company has moved its actual center of administration to its territory, irrespective of whether in that regard the company actually intended to transfer its seat.

²²⁹ Significantly, the CJEU itself suggested in *Überseering* that it had addressed the issue in *Daily Mail* as a matter of civil (company) law rather than as an issue of tax law.

²³⁰ Case C-371/10, *National Grid Indus*.

after transferring its place of effective management to another Member State.

The domestic legal provisions at issue confined themselves to attaching tax consequences, for a company incorporated under national law, to a transfer of the place of management between Member States, without the transfer affecting the status of that company as a company of the Member State in question (i.e., the state *from* which it transferred its place of management).

The CJEU held that a company incorporated under the law of a Member State that transferred its place of effective management to another Member State, without that transfer affecting its status as a company of the former Member State, could rely on Article 49 of the TFEU for the purposes of challenging the lawfulness of a tax imposed on it by the former Member State on the occasion of the transfer of the place of effective management.

Having established that National Grid Indus BV was entitled to rely on the freedom of establishment in the case at hand, the CJEU turned to the question of whether Article 49 of the TFEU had to be interpreted as precluding tax legislation of a Member State, such as that at issue, under which unrealized capital gains relating to the assets of a company incorporated under the law of that Member State that transferred its place of effective management to another Member State were taxed by the former Member State at the time of the transfer, without that legislation providing for:

- (i) The payment of the tax imposed on that company to be deferred until the time when the gains were actually realized; or
- (ii) Taking account of decreases in value that might occur after the transfer of the place of management.

Referring to *de Lasteyrie du Saillant* and *N*, the CJEU confirmed that since, in accordance with the Dutch legislation at issue, the transfer of the place of effective management of a Dutch company to another Member State entailed the immediate taxation of the unrealized capital gains relating to the assets transferred, while such gains were not taxed when such a company transferred its place of management within the Netherlands, this resulted in a difference of treatment that could not be explained by an objective difference of situation. This constituted a restriction that was, in principle, prohibited by the Treaty provisions on the freedom of establishment.

As regards the question of whether such a restriction could be justified by the objective of ensuring the balanced allocation of powers of taxation between Member States, in accordance with the principle of territoriality linked to a temporal component, the CJEU responded that the transfer of the place of effective management of a company of one Member State to another Member State could not mean that the Member State of origin had to abandon its right to tax a capital gain that arose within the ambit of its powers of taxation before the transfer.

Thus, in accordance with the principle of fiscal territoriality linked to a temporal component (i.e., the taxpayer's residence for tax purposes in the national territory during the period in which the capital gains arose), a Member State was entitled to charge tax on those gains at the time when the taxpayer left the country.

In the CJEU's view, referring, among other cases, to *Marks & Spencer*, such a measure was intended to prevent situations capable of jeopardizing the right of the Member State of origin to exercise its powers of taxation in relation to activities carried on in its territory, and could therefore be justified on the grounds connected with the preservation of the allocation of powers of taxation between the Member States.

However, it was also necessary to examine whether legislation such as that at issue went beyond what was necessary to attain the objective it pursued, i.e., whether it was proportional.

In making this assessment, the CJEU drew a distinction between:

- (i) The establishment of the amount of tax; and
- (ii) The recovery of the tax.

In the Court's opinion, while establishing the amount of tax at the time of the transfer of a company's place of effective management complied with the principle of proportionality,²³¹ the immediate recovery of the tax at the time when the company transferred its place of effective management to another Member State (as was the case under the national legislation at issue) was problematic.

According to the Court, national legislation offering a company transferring its place of effective management to another Member State the choice between:

- (i) Immediate payment of the amount of tax, which created a disadvantage for that company in terms of cash flow but freed it from subsequent administrative burdens; and
- (ii) Deferred payment of the amount of tax, possibly together with interest in accordance with the applicable national legislation,²³² which necessarily involved an administrative burden for the company in connection with tracing the transferred assets,

would constitute a measure that, while being appropriate for ensuring the balanced allocation of powers of taxation between

²³¹ The Commission, referring to the judgment in *N*, had submitted that, from the point of view of the principle of proportionality, the Member State of origin is required to take into account decreases in value that occur between the time of the transfer of the company's place of management and the realization of the assets concerned, if the host Member State's tax system does not take them into account. The CJEU disagreed with this on the grounds that, in contrast to the position in *N*, the assets of a company are assigned directly to economic activities that are intended to produce a profit. Since the profits of a company that transfers its place of effective management are, after the transfer, taxed exclusively in the host Member State, in accordance with the principle of fiscal territoriality linked to a temporal component, it is also for that Member State, in view of the connection between a company's assets and its taxable profits, and hence for reasons relating to the symmetry between the right to tax profits and the possibility of deducting losses, to take account in its tax system of fluctuations in the value of the assets of that company that occur after the date on which the Member State of origin loses all fiscal connection with the company. It follows from the foregoing that TFEU, Art. 49 does not preclude legislation of a Member State under which the amount of tax on unrealized capital gains relating to a company's assets is fixed definitively, without taking account of decreases or increases in value that may occur subsequently, at the time when the company, because of the transfer of its place of effective management to another Member State, ceases to obtain profits taxable in the former Member State. In the Court's opinion, it makes no difference that the unrealized capital gains that are taxed are exchange rate gains that cannot be reflected in the host Member State under the tax system in force in that State.

²³² Whether the charging of interest in (deferred) exit tax situations is compatible with the proportionality principle is still an open (and debated) issue.

the Member States, would be less harmful to freedom of establishment than a measure requiring immediate payment (such as under the national legislation at issue).

If a company were to consider that the administrative burden in connection with deferred recovery was excessive, it could opt for immediate payment of the tax.

Moreover, to take account of the risk of nonrecovery of the tax, which increased with the passage of time, the Member State in question could adopt, in its national legislation applicable to deferred payments of tax debts, measures such as a requirement for the provision of a bank guarantee.

Accordingly, legislation of a Member State that prescribed the immediate recovery of tax on unrealized capital gains relating to the assets of a company transferring its place of effective management to another Member State at the actual time of that transfer was disproportionate.

The CJEU subsequently confirmed its judgment in *National Grid Indus* in the context of infringement procedures against Portugal, The Netherlands, Spain and Denmark.²³³

In the last case, however, the CJEU added that exit States were not generally required to defer tax collection until the relevant assets were disposed of.

Exit States might determine an alternative triggering event, i.e., the Court held that Member States entitled to tax capital gains generated when the assets in question were in their territory had the power, for the purposes of such taxation, to make provision for a chargeable event other than the actual realization of those gains, to ensure that the gains on those assets are taxed.²³⁴

In *DMC*,²³⁵ a case concerning German legislation offering a taxpayer the choice between:

- (i) Immediate recovery of exit tax; or
- (ii) Recovery of such tax spread over a period of five years (irrespective of any realization event),

the CJEU found that the legislation did not go beyond what was necessary to attain the objective of the preservation of the balanced allocation of the power to impose taxes between Member States.²³⁶

²³³ Case C-38/10, *Commission v. Portugal*; Case C-301/11, *Commission v. the Netherlands*; Case C-64/11, *Commission v. Spain*; Case C-261/11, *Commission v. Denmark*.

²³⁴ See also Case C-164/12, *DMC*, in which the CJEU repeated this addition.

²³⁵ Case C-164/12, *DMC*. This case was decided under the free movement of capital rather than the freedom of establishment. The case was not on its facts a classic exit tax case: it involved a German reorganization under which, in essence, two Austrian corporate partners in a German limited partnership exchanged their partnership interests with a German company in return for shares in the latter. The German tax authorities considered that the transfer gave rise to a taxable gain, based on the going concern value of the partnership interests rather than the lower book value at which they were transferred. German law provided for such a valuation where a gain on the consideration shares would not be taxable in Germany. The referring court agreed with the tax authorities that, under the Germany-Austria tax treaty, Germany could not tax the shares. In the case of German resident partners, the assets could have been transferred at book value. The CJEU dealt with the case essentially as an exit tax case by treating the exchange of the partnership interests as the conceptual equivalent of an emigration.

²³⁶ See Case C-261/11, *Commission v. Denmark*, where the CJEU implicitly sanctioned the approach under which the deferred tax would become payable in instalments to guarantee the taxation of assets that were not likely to be dis-

posed of. This is different from *DMC*, in which phased deferral before actual realization was accepted merely because the risk of the non-recovery of tax increases over time.

With regard to the requirement to provide a bank guarantee where a taxpayer elected for deferred payment, the Court repeated that a Member State might take account of the risk of nonrecovery of the tax in the national legislation applicable to deferred payments of tax debts, but that such a guarantee in itself constituted a restrictive effect, in that it deprived the taxpayer of the enjoyment of the assets given as guarantee. Therefore, such a requirement was only compatible with EU law if it was imposed based on the *actual* risk of non-recovery of the tax. Prior assessment of the risk of nonrecovery was thus necessary.

In line with this case law was the decision in *Verder LabTec*,²³⁷ where, in connection with the transfer by a German limited partnership of patent, trademark and model rights to a PE located in the Netherlands, the Court held that the German tax administration's practice of a staggered recovery of the tax on the unrealized gain over a 10-year period was appropriate for ensuring the preservation of the allocation of the powers of taxation between the Member States concerned.

In *Trustees of the P Panayi Accumulation & Maintenance Settlements*,²³⁸ the CJEU held that an entity such as a trust that, under national law, possessed rights and obligations that enabled it to act in its own right, and that actually carried on an economic activity could rely on the freedom of establishment (since, in such circumstances, it fell within the scope of the concept of "other legal persons" within the meaning of Article 54 of the TFEU).

Where the trustees, under national law, were treated as a single and continuing body of persons, distinct from the persons that might from time to time be the trustees, Article 49 of the TFEU precluded legislation of a Member State that provided for the taxation of unrealized gains in the value of assets held in a trust when the majority of the trustees transfer their residence to another Member State, but failed to permit payment of the tax payable to be deferred.

In *A Oy*,²³⁹ the CJEU found the freedom of establishment to preclude a national (exit tax) provision (intended to implement Article 10(2) of the Merger Tax Directive — see III.B.1., below) imposing immediate taxation in the Member State of the transferring company where the PE transferred and the receiving company were situated in another Member State, whereas such taxation did not apply in a similar domestic case.

It follows from the foregoing case law overview that, as things currently stand, the CJEU's assessment of a justified exit tax on individuals deviates from its assessment of a justified exit tax on companies in two respects:

- (i) In the case of individuals, a proportionate exit tax requires the exit State to take account of reductions in value capable of arising after the transfer of residence. In the case of companies, Article 49 of the TFEU is considered not to preclude legislation of a Member State under which the amount of tax on unrealized capital gains relating to a

posed of. This is different from *DMC*, in which phased deferral before actual realization was accepted merely because the risk of the non-recovery of tax increases over time.

²³⁷ Case C-657/13, *Verder LabTec*.

²³⁸ Case C-646/15, *Trustees of the P Panayi Accumulation & Maintenance Settlements*.

²³⁹ Case C-292/16, *A Oy*.

company's assets is fixed definitively, without taking account of decreases or increases in value that may occur subsequently, at the time when the company, because of the transfer of its place of effective management to another Member State, ceases to obtain profits taxable in the former Member State.

(ii) Further, in the case of individuals, the requirement to provide guarantees in the case of deferred payment of the tax does not pass the least restrictive means test whereas, in the case of companies, such a requirement is deemed to be compatible with EU law if it is imposed based on the (actual) risk of nonrecovery of the tax.

Comment: The reason for these differences remains unclear.

By way of a final note, the “exit charge” cases should only be relevant in situations where there is a deemed disposal of assets on the migration of a person or company resulting in “unrealized” gains.

The reason the deferral is required in these situations is that it would be disproportionate to require upfront taxation of the gain on the assets where:

- (i) The taxpayer is not actually disposing of the assets; and
- (ii) The taxpayer therefore does not have the funds to pay the tax.

In contrast, in cases where the taxpayer actually disposes of assets (for example, shares) and thereby realizes capital gains, the same cashflow problems are not relevant and, hence, upfront or immediate taxation of such gains may not be deemed disproportionate.

In the light of the above, the CJEU held that a national rule imposing immediate taxation on the transfer of assets from a company resident in a Member State to a sister company resident in a third country, where the transferring company obtained full market value consideration and thus realized a capital gain on the assets concerned, did not constitute a restriction on the freedom of establishment within the meaning of Article 49 of the TFEU.²⁴⁰

In the meantime, exit taxes have been expressly addressed as one of the ATAD measures (see VI.B.3., below).

g. Corporate Conversions

In *Polbud—Wykonawstwo*,²⁴¹ the CJEU confirmed the right of companies to carry out cross-border conversions on the basis of the freedom of establishment.

The CJEU held that:

(i) The freedom of establishment was applicable when the registered office alone, without the real head office, was transferred from one Member State to another if the Member State of new incorporation accepted the registration of a company even without the exercise of an economic activity there. In that case, Article 49 of the TFEU did not require such economic activity as a precondition for its applicability.

(ii) In the absence of harmonization, Member States were competent to select the connecting factor of a company to its national order and thus apply their own incorporation requirements to incoming companies.

(iii) The fact that either the registered office or real head office of a company was established in accordance with the legislation of a Member State for the purposes of enjoying the benefit of more favorable legislation did not, in itself, constitute abuse.²⁴²

The CJEU concluded that a national rule which imposed the winding-up as a prerequisite for a cross-border transfer of a company constituted an unjustified and disproportionate restriction on the freedom of establishment and was therefore unlawful.

h. Transfer Pricing — Intra-Group Transfers

*X and Y*²⁴³ concerned the exclusion of X and Y, natural persons of Swedish nationality resident in Sweden, as transferors at undervalue of shares in companies, from the benefit of deferral of the tax due on capital gains made on those shares through the application of a national rule providing for such exclusion where the transfer was to:

- (i) A foreign legal person in which the transferor directly or indirectly had a holding; or
- (ii) A Swedish limited company in which such a foreign legal person either directly or indirectly had a holding.

The CJEU carried out its analysis in the context of both the freedom of establishment and the free movement of capital and found the Swedish exclusion rule to constitute an unjustifiable restriction on these freedoms.

In *Oy AA*,²⁴⁴ a Finnish company effected a transfer in favor of its loss-making U.K. parent company.

Finland refused the deduction of the amount of the transfer from Oy AA's taxable income because the parent company was not Finnish.

While the CJEU found that the freedom of establishment was restricted, it considered the Finnish legislation to be justified by:

- (i) The need to maintain the balanced allocation of the power to tax between Member States; and
- (ii) The need to prevent tax avoidance.

In the Court's view, the legislation was:

- (i) Pursuing legitimate objectives;
- (ii) Justified by overriding reasons of public interest; and
- (iii) Appropriate for ensuring the attainment of the legitimate objectives (see also the discussion of this case at II.E.4.b., above).

In *SGI*,²⁴⁵ a Belgian resident company granted an interest-free loan to its French subsidiary and paid an excessive director's fee to a related Luxembourg company.

²⁴² This is in line with the CJEU's earlier judgments in *Daily Mail*, *Cartesio*, and *Vale* discussed at II.E.4.f., above.

²⁴³ Case C-436/00, *X and Y*.

²⁴⁴ Case C-231/05, *Oy AA*.

²⁴⁵ Case C-311/08, *SGI*.

²⁴⁰ Case C-707/20, *Gallaher*.

²⁴¹ Case C-106/16, *Polbud — Wykonawstwo*.

The Belgian tax authorities added to SGI's taxable income the interest that it should have charged on the loan and disallowed the excess director's fee as a tax-deductible business expense.

Such an adjustment of the company's accounts could be made only if the related company was not resident in Belgium (if the other company was a Belgian resident company subject to Belgian corporate income tax, there would be no tax avoidance).

The CJEU found the adjustment to amount to a restriction on the freedom of establishment. However, the Court accepted that it was justified based on:

- (i) The balanced allocation of taxing power; and
- (ii) The objective of preventing tax avoidance,

taken together.

In *Hornbach-Baumart*,²⁴⁶ Hornbach-Baumart AG ("Hornbach") a German resident parent company, granted comfort letters to a unrelated bank to guarantee external financing of its two indirectly held 100% Dutch subsidiaries. Hornbach did not receive any remuneration from the subsidiaries for the issuing of the comfort letters. The German tax authorities:

- (i) Considered that the comfort letters had not been granted on an arm's length basis; and
- (ii) Increased the income of Hornbach to reflect the notional remuneration that an unconnected third party would normally had paid in consideration for the comfort letters.

Hornbach argued that the increase in its taxable income effectively penalized the company, and constituted unequal treatment between cases involving domestic transactions and those involving foreign transactions, contrary to the freedom of establishment, since purely domestic transactions did not attract such a notional increase in income.

Referring to its holding in *SGI* (see above), the CJEU held that the German transfer pricing legislation constituted a restriction of the freedom of establishment that was justifiable based on the need to preserve the balanced allocation of powers to impose taxes between the Member States. This was because the legislation at issue sought to prevent profits generated in the Member State concerned from being transferred tax-free outside that State's tax jurisdiction via transactions that were not in accordance with market conditions.

In confirming the proportionality of the German legislation at issue, however, the CJEU emphasized that the gratuitous granting of comfort letters containing a guarantee statement could possibly be explained by:

- (i) The economic interests of Hornbach in the financial success of its foreign subsidiaries (in which it participated through the distribution of profits); and
- (ii) A certain degree of responsibility that Hornbach had, in its capacity as a shareholder, in the financing of those companies.

As such, the CJEU concluded that the German transfer pricing legislation did not go beyond what was necessary to achieve the objective that it pursued, *provided* the authorities

responsible for the enforcement of that legislation afforded the resident taxpayer the opportunity to prove that the terms at issue were agreed on for commercial reasons that could be regarded as resulting from its status as a shareholder in the non-resident company. This was for the national court to determine.

In *Test Claimants in the Thin Cap Group Litigation*,²⁴⁷ *SGI*,²⁴⁸ *Hornbach-Baumart*,²⁴⁹ and *Lexel AB*,²⁵⁰ the CJEU confirmed that the arm's length standard served as a unique "safe harbor," i.e., if a transaction was at arm's length, it should never be considered a wholly artificial arrangement.

The CJEU's ruling in *X BV*,²⁵¹ a case that concerned a Dutch interest deduction provision, cast doubt on this position.

In *X BV*, following the opinion rendered by Advocate General Emiliou,²⁵² the CJEU held that Article 49 of the TFEU "must be interpreted as not precluding national legislation under which, in the determination of a taxpayer's profits, the deduction of interest paid in respect of a loan debt contracted with a related entity, relating to the acquisition or extension of an interest in another entity which becomes, as a result of that acquisition or extension, an entity related to that taxpayer is to be refused in full, where that debt is considered to constitute a wholly artificial arrangement or is part of such an arrangement, even if that debt was incurred on an arm's length basis and the amount of that interest does not exceed that which would have been agreed between independent undertakings." This seems at odds with the proposition apparently put forward in earlier case law to the effect that arm's length conditions apply as a safe harbor with respect to the principle of the "prohibition of abuse of right."

The CJEU's current position thus seems to be that the fact that the terms of an intra-group loan are at arm's length cannot prevent the loan being characterized as an "abusive practice" if the loans has no valid commercial reason apart from the obtaining of tax benefits that contradict the purpose of relevant tax provisions and EU law. This is particularly relevant in the context of the proportionality analysis of a Member State's tax measure.

For example, in *Lexel AB*, which concerned a Swedish interest deduction limitation, the Court held that even where a transaction "represents a purely artificial arrangement without any underlying commercial justification, the principle of proportionality requires that the refusal of the right to a deduction should be limited to the proportion of that interest which exceeds what would have been agreed had the relationship between the parties been one at arm's length."²⁵³

²⁴⁷ Case C-524/04, *Test Claimants in the Thin Cap Group Litigation*.

²⁴⁸ Case C-311/08, *SGI*.

²⁴⁹ Case C-382/16, *Hornbach-Baumart*.

²⁵⁰ Case C-484/19, *Lexel AB*.

²⁵¹ Case C-585/22, *X BV*.

²⁵² In his opinion, the Advocate General had urged the Court to revisit the approach it took in *Lexel*. The CJEU, however, did not follow the Advocate General on this point, arguing that the economic validity of the loan and the related transactions at issue in *Lexel* had neither been challenged before the Court nor examined by it and that, consequently, it cannot be inferred from that judgment that, where a loan and the related transactions are not justified by economic considerations, the mere fact that the terms of that loan correspond to those which would have been agreed between independent undertakings means that that loan and those transactions do not, by definition, constitute wholly artificial arrangements.

²⁵³ Case C-484/19, *Lexel AB*.

²⁴⁶ Case C-382/16, *Hornbach-Baumart*.

This position also follows, *a contrario*, from *X BV*,²⁵⁴ in which the CJEU held that where a loan is, in itself, devoid of economic justification and, but for the relationship between the contracting companies and the tax advantage sought, would never have been entered into, it is consistent with the principle of proportionality to deny a deduction for all the interest, since such a wholly artificial arrangement must be ignored by the tax authorities when calculating the corporate tax due. According to the Court, denying a deduction for only a fraction of the interest paid on the loan would allow the taxpayer to obtain a partial, or even the entire, tax advantage sought through abusive means, which would call into question the coherence of the anti-abuse regime.

i. Ownership of Shares

*Baars*²⁵⁵ concerned a Dutch resident who owned a company established in Ireland.

While the Netherlands imposed a wealth tax on all individuals, the Dutch tax legislation at issue provided that, where a holding in the capital of a company conferred on a Dutch individual resident shareholder a definite influence over the company's decisions (which was the case here, as Mr. Baars held a 100% shareholding in the (Irish) company), allowed the individual an exemption, in whole or in part, from wealth tax with respect to the assets invested in shares in the company.

However, the legislation made the exemption subject to the condition that the holding had to be in a company established in the Netherlands, thus denying it to holders of shares in companies established in other Member States (including Mr. Baars).

According to the CJEU:

(i) By refusing to grant the tax advantage to nationals of Member States resident in the Netherlands who, in exercising their right of free establishment, managed a company having its seat in a Member State other than the Netherlands; and

(ii) While granting that advantage to nationals of Member States resident in the Netherlands who had substantial holdings in companies having their seats in the Netherlands,

the Dutch legislation at issue provided for a difference in treatment of taxpayers by making the location of the seat of the companies of which those taxpayers were shareholders a criterion for its application.

The Court found that such a difference in treatment constituted an unjustifiable restriction on the freedom of establishment.

j. Costs Related to Shareholdings

*Bosal Holding*²⁵⁶ concerned Bosal Holding BV, a limited liability company established in the Netherlands and carrying on holding, financing and licensing/royalty-related activities.

The company sought to deduct from its taxable profits interest costs incurred in relation to the financing of its holdings in companies in other Member States.

Under Dutch tax legislation in force at the time, holding costs that were indirectly instrumental in taxable profits being made in the Netherlands were deductible.

However, holding costs that were indirectly instrumental in taxable profits being made abroad were not deductible.

The CJEU took the position that, although the Parent-Subsidiary Directive offered Member States the possibility of denying deductions for costs incurred by parent companies in connection with holdings in the capital of their subsidiaries, that possibility could only be exercised in compliance with the fundamental provisions of the Treaty.

The Court therefore concluded that the Parent-Subsidiary Directive, interpreted in the light of the freedom of establishment, precluded a national provision that, for the purposes of determining the tax on the profits of a parent company established in one Member State, made the deductibility of costs in connection with that company's holding in the capital of a subsidiary established in another Member State subject to the condition that such costs be indirectly instrumental in making profits that were taxable in the Member State in which the parent company was established.

In *Keller Holding*,²⁵⁷ a German company was barred from deducting the portion of its financing costs corresponding to its participation in an Austrian subsidiary, because a foreign dividend was exempt, while a dividend of German origin would have been taxable, but subject to a credit for the underlying German corporate income tax, which had the same effect as an exemption.

The CJEU held that denying the deduction with respect to legally exempt foreign dividends while allowing the deduction with respect to economically ("in fact") exempt domestic dividends amounted to an unjustifiable restriction on the freedom of establishment.

k. Capital Gains Tax on Sales of Shares

At issue in *De Baeck*²⁵⁸ were Belgian income tax rules under which:

(i) Capital gains realized on the sale of a substantial shareholding (25% or more of the capital) in a Belgian company to a foreign entity were taxed at the rate of 16.5%; while

(ii) A Belgian resident individual was (in principle) not subject to tax on capital gains realized on his/her private assets (securities, tangible assets or real property) if the gains were realized on transactions that were within the limits of the normal management of a private estate.

The CJEU, deciding the case by way of a reasoned opinion, found that the Belgian legislation was contrary to the freedom of establishment if the seller's holding conferred on him an influence in the management of the company concerned and that the restriction was otherwise contrary to the free movement of capital.

²⁵⁴ Case C-585/22, *X BV*.

²⁵⁵ Case C-251/98, *Baars*. Compare with Case C-242/03, *Weidert and Paulus* decided under the free movement of capital.

²⁵⁶ Case C-168/01, *Bosal Holding*.

²⁵⁷ Case C-471/04, *Keller Holding*.

²⁵⁸ Case C-268/03, *De Baeck*.

In *X*,²⁵⁹ the CJEU found Article 49 of the TFEU not to preclude the tax legislation of a Member State that, in principle, exempted capital gains on holdings for business purposes from corporation tax and, by the same token, disallowed the deduction of capital losses on such holdings, even where those capital losses were due to currency losses.

1. Interest Payments

*Truck Center*²⁶⁰ concerned a Belgian resident company that was 48% owned by Wickler Finances, a Luxembourg resident company.

In February 1992, Wickler Finances granted a loan to Truck Center on which interest was payable.

During the years from 1994 to 1996, interest on the loan accrued in the accounts of Truck Center, but was not actually paid.

In those years, under Belgian law, withholding tax was due on interest payable to a nonresident. However, no withholding tax was due on interest payable to a resident company (or a Belgian PE of a nonresident company.)

The obligation to withhold tax:

- (i) Applied to interest accrued; and
- (ii) Was not limited to interest actually paid.

The CJEU held that the Belgian rule was not incompatible with the freedom of establishment or the free movement of capital.²⁶¹

In the Court's view:

The payment of interest by one resident company to another resident company; and

The payment of interest by a resident company to a nonresident company gave rise to two distinct charges resting on separate legal bases:

- (i) Withholding tax was not charged on interest paid by one resident company to another resident company, however, the interest was taxed by the Belgian State because it remained subject to corporation tax in the hands of the latter company, in the same way as that company's other income;
- (ii) The Belgian State retained at source withholding tax on interest paid by a resident company to a nonresident company under the discretionary power which, under the Belgium-Luxembourg tax treaty, Belgium and Luxembourg had mutually reserved for themselves in the allocation of their powers of taxation.

Comment: The CJEU's approach clearly focused on the taxation of the lender in receipt of the interest.

²⁵⁹ Case C-686/13, *X*.

²⁶⁰ Case C-282/07, *Truck Center*.

²⁶¹ The Belgian court had referred to the free movement of capital, but as the withholding tax of 15% under the Belgium-Luxembourg tax treaty applied only where there was a shareholding of 25% or more, the CJEU concluded that the freedom of establishment was engaged. If the position is considered a little further, however, the Belgian court may have referred to the correct freedom. First, the lender held 48% of the shares in Truck Center; if the remaining 52% of the shares were held by an unassociated company, then the 48% would not have given Wickler Finances control of Truck Center (assuming actual control is necessary to satisfy the freedom of establishment test of substantial influence).

However, the question referred by the Belgian court related to the obligation of the borrower to pay over an amount with respect to tax when it accrued interest payable to a nonresident.

The true comparison would have involved a discussion of whether a Belgian borrower would have to pay over an amount with respect to tax when it accrued interest payable to a Belgian lender.

While it is correct that the tax was paid over with respect to an ultimate liability of the Luxembourg lender, the question itself referred only to the obligation imposed on a borrower to withhold tax.

Arguably, therefore, the answer the Court should have given, on a correct analysis of the issue and in response to the question actually posed, was that:

- (i) It was not incompatible with the free movement of capital (or the freedom of establishment) to impose a withholding tax obligation on a borrower that actually paid (and did not merely accrue) interest to a nonresident, even when there was no withholding tax on the payment of interest to a resident lender.
- (ii) However, it was not compatible with such free movement to impose a withholding tax on interest that was accrued (and not actually paid over) to a nonresident where there was no equivalent withholding tax on interest accrued to a resident lender.

m. Goodwill

In *Finanzamt Lintz*,²⁶² the CJEU considered an Austrian tax provision under which the ability to depreciate goodwill for purposes of group taxation in the context of an acquisition depended on whether the holding acquired was in a resident or a nonresident company. The provision concerned allowed up to 50% of the acquisition price to be depreciated where a parent company acquired a holding in a resident company, but allowed no such depreciation where the parent acquired a holding in a nonresident company. The court held the provision to be impermissible under the freedom of establishment principle.

n. Interest Deduction Limitation/Combination of Interest Deduction Limitation and Group Contribution Rules

*Lexel AB*²⁶³ concerned a Swedish interest deduction limitation under which interest payments to an affiliated party were, in principle, deductible if the income was subject to a tax rate of at least 10%, unless the main reason for entering into the loan agreement was to gain a substantial tax benefit.

In a purely domestic situation, however, the exception could not be applied as two Swedish group companies would be in a position to carry out intragroup financial transfers and hence achieve deductibility without being subject to any limitation regarding a substantial tax benefit. As a result, the substantial tax benefit exception would never arise in a domestic context.

The CJEU considered the cross-border situation to be comparable to a purely domestic situation because a situation

²⁶² Case C-66/14, *Finanzamt Linz*.

²⁶³ Case C-484/19, *Lexel AB*.

where a company established in one Member State made interest payments to a company established in another Member State and belonging to the same group was no different from a situation where the recipient of the payments was a company of the same Member State and belonging to the same group.

Consequently, the CJEU held the interest deduction limitation measure to be incompatible with the freedom of establishment.

Turning to the issue of justification, the Court rejected the prevention of tax avoidance defense.

The CJEU noted that, as the substantial tax benefit did not only target wholly artificial arrangements, but also transactions between companies in accordance with the arm's-length principle, "the principle of proportionality requires that the refusal of the right to a deduction should be limited to the proportion of that interest which exceeds what would have been agreed had the relationship between the parties been one at arm's length."

The Court thereby confirmed its earlier jurisprudence following which, if a transaction was at arm's length, it should never be considered as a wholly artificial arrangement.²⁶⁴

The Court also rejected the argument that the different treatment could be justified by the need to safeguard the balanced allocation of the power to impose taxes between the Member States.

While the Swedish provision at issue sought to prevent the erosion of the Swedish tax base through interest payments to foreign companies, such an objective could not be confused with the need to preserve the balanced allocation of the power to impose taxes between the Member States.

The Court also noted that the interest payments would have been deductible if they had been made to a non-group member, adding that where the conditions of a cross-border intragroup transaction and an external cross-border transaction corresponded to those on an arm's length basis, there was no difference between those transactions in terms of the balanced allocation of the power to impose taxes between the Member States.

The Court then analyzed whether the justification was possible by taking both grounds of justification together, as it did in *SGI*.²⁶⁵ The Court concluded that taking these justifications together was not possible if a measure was clearly not based on the need to preserve a balanced allocation of the power to impose taxes between the Member States.

In other words, if none of the grounds of justification was applicable in the first place, a combination of such (non-accepted) grounds of justification would not succeed either.²⁶⁶

Comment: A question arises as to whether the holding of the CJEU in *Lexel AB* potentially affects the compatibility of

the option granted by Article 4(1) of ATAD 1 (see VI.B.2., below) with the freedom of establishment.

Article 4(1) of ATAD 1 allows the Member States to treat domestic tax groups as a single taxpayer, meaning that domestic intragroup payments are effectively disregarded (as the interest expense of one group member matches the interest income of another), whereas no similar group perspective is available for EU cross-border groups.

At issue in the European Free Trade Association (EFTA) case, *PRA Group Europe AS v Staten v/Skatteetaten*,²⁶⁷ was Norwegian tax legislation allowing a company liable to tax in Norway to mitigate or eliminate the effect of rules limiting interest deductions with respect to loans taken out with affiliated companies by making use of the group contribution rules.

This possibility was available provided the company concerned was a member of a group of companies liable to tax in Norway. It was not available to a group consisting of companies liable to taxation in other EEA States.

According to the EFTA Court, which extensively referred to the CJEU's holding in *Lexel AB* (see above), this arrangement, which was a consequence of the combination of:

- The rules limiting interest deductions; and
- The group contribution rules,

might restrict companies' ability to exercise the freedom of establishment.

In particular, Norwegian companies that formed part of a group with companies in other EEA States and wished to take out an intragroup loan were precluded from mitigating or eliminating the effect of the rules limiting interest deductions.

Such companies were therefore placed at a disadvantage when compared to companies in groups composed solely of companies established in Norway.

While acknowledging that, according to settled case law, group contribution rules might be justified by the need to preserve the balanced allocation of taxing powers between EEA States (thus making it legitimate for an EEA State to limit certain tax advantages to domestic groups of companies, to the exclusion of non-EEA resident companies),²⁶⁸ the Court noted that the restriction in the present case derived from the combination of the limitations on interest deductibility and the group contribution rules, rather than the group contribution rules considered in isolation.

In other words, the issue in that case did not pertain to the group contribution rules *per se*, but to the difference in treatment arising from the ability of a Norwegian company or com-

²⁶⁴ See e.g., Case C-524/04, *Test Claimants in the Thin Cap Group Litigation*; Case C-311/08, *SGI*; Case C-382/16, *Hornbach-Baumart*; Case C-484/19, *Lexel AB*. See the discussion at C.3.h. and E.4.e., above.

²⁶⁵ Case C-311/08, *SGI*, where the CJEU found that the need to maintain the balanced allocation of the power to tax between the Member States and to prevent tax avoidance, taken together, justified the Belgian legislation at issue in that it pursued legitimate objectives that are compatible with the Treaty and constitute overriding reasons in the public interest and that it is appropriate for ensuring the attainment of those objectives.

²⁶⁶ See the discussion at C.3.g., above.

²⁶⁷ Case E-3/21, *PRA Group Europe AS v Staten v/Skatteetaten*.

²⁶⁸ Specifically, the EFTA Court observes that group contributions allow intra-group transfers of profits, from one company to another within the same domestic group, without the payment of consideration in return. The absence of consideration entails that such transfers should not be understood as transactions of a commercial nature, in the ordinary sense. It would undermine the balanced allocation of powers to impose taxes according to the principle of territoriality if taxpayers had a free choice to decide in which State a profit is taxed or a loss is taken into account and the possibility of freely moving the taxable base between EEA States. In such cases, there is no scope to test the commercial nature of the contributions by, for example, an assessment at arm's length. The arm's length principle states that transactions between associated enterprises should not be distorted by the special relationship that exists between the parties.

panies within a group to use such rules to lessen or remove the impact of another set of rules, namely the rules limiting interest deductions.

In the EFTA Court's opinion, the desirability of ensuring a balanced allocation of the taxing rights between EEA States was not capable of justifying a restriction arising in the circumstances where a tax deduction was granted in a domestic but not a cross-border situation.

Rather, and in particular, if an EEA State granted such a benefit in a domestic situation (thus renouncing some of its taxing rights), that EEA State could not argue that the same taxing rights were important in the cross-border situation in an attempt to limit equal treatment.

Consequently, the difference in treatment did not appear justified by the need to safeguard the balanced allocation of the power to impose taxes between EEA States.

The EFTA Court admitted, however, that a restriction such as the one at issue in the case at hand could be justified where it served the legitimate objective of preventing wholly artificial arrangements leading to tax avoidance.

However, national law that did not provide the taxpayer with the opportunity to demonstrate that the transaction concerned took place on terms corresponding to what would have been agreed had the relationship between the parties been at arm's length (which is something for the referring court to determine) went beyond what was necessary to pursue that objective.

o. Shell Companies

In *Contship Italia*,²⁶⁹ the question brought before the CJEU concerned, in essence, whether the freedom of establishment enshrined in Article 49 of the TFEU precluded legislation, which restricted the ground for exclusion from the scope of the measures to prevent tax avoidance by shell companies, to companies whose securities were traded on domestic regulated markets.

Conversely, under the national legislation in question, other companies, whether domestic or foreign, whose securities were not traded on national regulated markets but that were controlled by companies and entities listed on foreign regulated markets were outside the scope of the ground for exclusion.

At issue was an Italian company, wholly-owned by a company listed on the stock exchange in Germany, that qualified as a "pure holding" company since its activity consisted exclusively in managing its shareholding in another Italian company of which it was the sole shareholder.

The Italian tax authorities deemed the Italian (sub)holding company to satisfy the criteria for constituting a shell company and, under Italian anti-shell company tax law as it stood at that time, determined the holding's taxable basis by reconstructing it from the value of its sole asset, i.e., the 100% shareholding in the Italian subsidiary.

Under that law, only "companies and entities whose securities were traded on Italian regulated markets" qualified for exclusion from the scope of the anti-shell company measures.

In its judgment of October 6, 2022, the CJEU held that it was clear that the legislation at issue did not give rise to any difference in treatment between:

- (i) A company held by a parent company listed in Germany, such as the Italian (sub)holding company; and
- (ii) A company held by a parent company listed in Italy.

According to the Court, given that the law allowed only companies that were *themselves* listed on the Italian regulated market to take advantage of the ground for exclusion from the scope of the anti-shell company measures, whether a company was the subsidiary of a parent company listed in Italy or a subsidiary of a parent company listed abroad had no relevance.

On the basis of the above, the CJEU concluded that Article 49 of the TFEU had to be interpreted as not precluding national legislation that restricted the grounds for exclusion from the scope of the anti-shell company measures to companies whose securities were traded on domestic regulated markets, excluding from the scope of the ground other companies, whether domestic or foreign, whose securities were not traded on domestic regulated markets but that were controlled by companies and entities listed on foreign regulated markets.

See, also, the discussion of the proposed ATAD 3 (Anti-Shell Proposal).

5. Freedom to Provide Services

The jurisprudence of the CJEU in the direct tax area originating under the freedom to provide services has been far less abundant than the case law originating under the freedom of establishment (or the free movement of capital — see II.E.6., below).²⁷⁰

In *Bachmann*,²⁷¹ the Belgian legislation disallowing the deduction for tax purposes of insurance premiums paid to foreign insurers not established in Belgium was also challenged as being contrary to the freedom to provide services.

Mr. Bachmann argued, in substance, that provisions such as the Belgian rules at issue, which required an insurer to be established in Belgium as a condition for the eligibility of insured persons to benefit from certain tax deductions in Belgium, operated to deter those seeking insurance from approaching insurers established in another Member State.

The CJEU acknowledged that such provisions amounted to a restriction on the freedom to provide services.

However, the Court nonetheless considered — having regard to the (alleged) direct link between the deductibility of the insurance premiums and the taxation of the sums payable by insurers — that the Belgian legislation was justified by the need to ensure the cohesion of the Belgian tax system.

²⁷⁰ There are, however, a significant number of cases concerning indirect taxes. See, e.g., Case C-18/93, *Corsica Ferries*, Case C-381/93, *Commission v. France*, and Joined Cases C-430/99 and C-431/99, *Sea-Land Service* (tariffs or charges imposed for port and maritime transport services); Case C-17/00, *De Coster* (Belgian local tax on satellite dishes); Case C-92/01, *Stylianakis* (Greek airport tax imposing on flights of more than 750 km a charge double that imposed on shorter flights); Case C-134/03, *Viacom Outdoor* (local tax on the posting of bills); Joined Cases C-544/03 and 545/03, *Mobistar and Belgacom Mobile* (Belgian local taxes on transmission pylons, masts and antennae for GSM and on external antennae).

²⁷¹ Case 204/90, *Bachmann*.

²⁶⁹ Joined Cases C-433/21 and C-434/21, *Contship Italia*.

Cases such as *Safir*, *Danner*, *Skandia* and *Ramstedt* and *Commission v. Denmark* concern very similar matters (albeit they show an increased reluctance on the part of the CJEU to accept the grounds of justification invoked by the respective Governments.)²⁷²

In *Eurowings*,²⁷³ payments for the lease of an aircraft made to a lessor that was an Irish limited company were subject to 50% add-back for German tax purposes although they would have been fully deductible had the lessor been resident in Germany and thus subject to German trade tax.

Having recalled the obligation of Member States to exercise their tax competence consistently with EU law, the CJEU held that since leasing was a service within the meaning of (now) Article 57 of the TFEU, (now) Article 56 of the TFEU required not only the abolition of any discrimination on account of nationality against a person providing services but also the abolition of any restriction on the freedom to provide services imposed on the grounds that the person providing the services was established in a Member State other than that in which the services were provided.

The Court considered the differences in the tax rules under examination and their dissuasive effect on German undertakings leasing goods from lessors established in other Member States.

The CJEU held that any legislation of a Member State that reserved a fiscal advantage for the majority of undertakings that leased goods from lessors established in that State while depriving those leasing from lessors established in another Member State of such an advantage, gave rise to an unjustifiable difference of treatment based on the place of establishment of the provider of services.

In *Gerritse*,²⁷⁴ the Court held that a national provision that refused to allow nonresidents to deduct business expenses for tax purposes, when residents were allowed to do so, risked operating mainly to the detriment of nationals of other Member States and therefore constituted indirect discrimination on the grounds of nationality, which was contrary to (now) Articles 56 and 57 of the TFEU.

*Lindman*²⁷⁵ concerned Finnish rules under which winnings from lotteries held in other Member States were regarded as taxable income of the winner chargeable to income tax, while winnings from lotteries held in Finland were exempt from tax. The CJEU concluded that the rules had a manifestly discriminatory character, incompatible with the freedom to provide services.

*Laboratoires Fournier*²⁷⁶ involved a French rule under which a tax credit for research was available to resident companies only if the research was carried out in France.

According to the CJEU, a national measure that limited the benefit of a tax credit for research only to research carried out in the Member State concerned made the provision of services

constituted by the research activity subject to different tax treatment depending on whether the research was carried out in the Member State concerned or in other Member States.

Such a measure thus differentiated according to the place where the services were provided, which contravened the freedom to provide services.

At issue in *Scorpio*²⁷⁷ was whether, in general, a German withholding tax affecting nonresident service providers, such as artists and sportsmen/sportswomen, was in line with the fundamental freedoms.

In contrast, German resident artists and sportsmen/sportswomen were:

- Not subject to such withholding tax and could simply file income tax returns at the end of the year; and
- Only taxed after the filing of such returns by way of an annual income tax.

The CJEU held that this difference in tax treatment was an obstacle to the freedom to provide services.

However, the legislation was nevertheless justified by the need to ensure the effective collection of income tax.

A related question was whether expenses directly linked to the performances of the nonresident artists and sportsmen/sportswomen had to be deducted to ensure that the German withholding tax was only levied on net income after the deduction of expenses, i.e., the profit from the performances.

The Court held, building on *Gerritse*, that the freedom to provide services precluded national legislation that did not allow a recipient of services that was the debtor with respect to the payment to be made to a nonresident provider of services, when withholding tax at source, to deduct the business expenses:

- Reported by the service provider; and
- Directly linked to the service provider's activity in the Member State in which the services were provided,

whereas a provider of services resident in that State was taxable only on net income, i.e., the income received after deduction of business expenses.²⁷⁸

*Commission v. Germany*²⁷⁹ concerned German legislation that made the granting of tax relief subject to the condition that school fees had to be paid to private schools approved by the German State or authorized/recognized by the law of the Land, which presupposed that they were established in Germany.

According to the CJEU, the legislation excluded the possibility for taxpayers in Germany to deducting from their taxable income a part of the school fees for sending their children to a private school established outside Germany, save for school fees paid in another Member State to:

- German schools recognized by the permanent conference of the Ministers of Education and Culture of the Länder; or
- European schools,

²⁷² Case C-118/96, *Safir*; Case C-136/00, *Danner*; Case C-422/01, *Skandia* and *Ramstedt*; Case C-150/04, *Commission v. Denmark*. See also Case C-334/02, *Commission v. France*, concerning a less favorable tax regime applied to investment income where the investment company was not established in France.

²⁷³ Case C-294/97, *Eurowings*.

²⁷⁴ Case C-234/01, *Gerritse*.

²⁷⁵ Case C-42/02, *Lindman*.

²⁷⁶ Case C-39/04, *Laboratoires Fournier*.

²⁷⁷ Case C-290/04, *Scorpio*.

²⁷⁸ See also Case C-345/04, *Centro Equestre da Lezíria Grande*.

²⁷⁹ Case C-318/05, *Commission v. Germany*.

whereas that possibility was available in relation to school fees paid to certain German private schools.

The Court held that the legislation, for which it saw no objective justification, was incompatible with the freedom to provide services.²⁸⁰

In the infringement procedure case *Commission v. Belgium*,²⁸¹ the Commission criticized a Belgian tax measure designed to deal with tax fraud in the construction sector.

Under the rule, principals and contractors that had recourse to unregistered contractors and subcontractors had to:

- (i) Withhold 15% of the payments made to such unregistered contractors and subcontractors; and
- (ii) Pay the withheld sum over to the Belgian tax authorities.

The principal or contractor was jointly and severally liable for the tax debts of the unregistered contractor or subcontractor (although this liability was subject to a cap).

According to the CJEU, given the disadvantage for unregistered service providers of not being able to immediately dispose of part of their income (which they could only recover following the conclusion of an administrative procedure), the unregistered service providers not established in Belgium were likely to be deterred from accessing the Belgian market.

Moreover, in the Court's view, the joint liability for tax debts of the unregistered service provider that was imposed on the principal or contractor was liable to dissuade the latter from having recourse to the services of providers established in other Member States.

Even if joint liability applied without distinction when an unregistered service provider was used, regardless of whether that service provider was established in Belgium or in another Member State, while it did not deprive service providers who were not registered and established in Belgium of the ability to supply their services there, the disputed provision made access to the Belgian market more difficult for them.

The Court therefore concluded that the withholding obligation and the imposition of the joint liability constituted restrictions on the freedom to provide services for which no proportional justification was available.²⁸²

In *Jundt*,²⁸³ a restriction on the freedom to provide services constituted by the fact that the national legislation concerned confined the application of an exemption from income tax to remuneration paid by universities (i.e., public-law persons) established on national territory, in return for teaching activities carried out on a secondary basis, and did not apply that exemption where the remuneration was paid by a university established in another Member State, was held not to be justified by overriding reasons of public interest.

²⁸⁰ See also Case C-76/05, *Herbert Schwarz, Marga Gootjes-Schwarz*.

²⁸¹ Case C-433/04, *Commission v. Belgium*.

²⁸² Compare with Case C-678/11, *Commission v. Spain* — obligation for pension funds established in Member States other than the Kingdom of Spain and offering occupational pension schemes in that Member State and insurance companies operating in Spain under the freedom to provide services to appoint a tax representative resident in that Member State considered to be incompatible with TFEU, Art. 56; and Case C-98/14, *Berlington Hungary* (tax on slot machines operated in amusement arcades).

²⁸³ Case C-281/06, *Jundt*.

At issue in *Commission v. Belgium*²⁸⁴ were Belgian tax provisions exempting interest derived from savings deposits from income tax (subject to an annually indexed cap).

To benefit from the exemption, the savings accounts concerned had to:

- (i) Be opened with a bank established in Belgium; and
- (ii) Satisfy certain criteria such as:
 - Currency;
 - Methods of withdrawal and deduction;
 - Structure; and
 - Level and calculation of remuneration.

The Court found that the provisions had the effect of:

- Discouraging Belgian residents from using services provided by banks established in other Member States, as interest payments made by those banks were not eligible for the exemption; and
- Discouraging holders of Belgian savings accounts from transferring their accounts to banks established in other Member States,

thus restricting the freedom to provide services enshrined in Article 56 of the TFEU.

The Court dismissed all justifications of the restriction put forward by Belgium, i.e.:

- The need to guarantee the effectiveness of fiscal supervision and the ineffectiveness of Directive 77/799 on mutual assistance; and
- The need to prevent double exemption, tax evasion and tax avoidance,

and concluded that the national provisions were precluded under the freedom to provide services contained in the EEA Agreement.

Following that judgment, the exemption system was amended in such a way that, although applicable without distinction to income from savings deposits held with banking service providers established in Belgium or in another EU Member State or a State belonging to the EEA, it was reserved to income from savings deposits held with banks complying with certain conditions.

However, these conditions (particularly those involving the method of remuneration of such deposits) were in fact specific to the national Belgian banking sector.

In *Van der Weegen and Others*,²⁸⁵ the CJEU held that the system, as amended, was incompatible with Article 56 (and Article 36 of the EEA Agreement) to the extent that it imposed conditions for access to the Belgian banking market on service providers established in other Member States (which the Court stated was a matter for the referring court to verify).

²⁸⁴ Case C-383/10, *Commission v. Belgium*. Compare with Case C-387/11, *Commission v. Belgium*, where different rules for the taxation of income from capital and movable property according to whether the income was earned by a resident investment company or a nonresident investment company with no PE in Belgium were found to fall foul of the freedom of establishment (and the free movement of capital).

²⁸⁵ Case C-580/15, *Van der Weegen and Others*.

In *Commission v. Belgium*,²⁸⁶ the CJEU found a Belgian withholding tax on interest payable on debts backed by Belgian securities when the securities were deposited or registered in an account in a financial institution established in another Member State or a State belonging to the EEA, whereas that interest was exempt from withholding tax when the securities were deposited or registered in an account in a financial institution in Belgium, to be incompatible with Article 56 of the TFEU.

*Brisal*²⁸⁷ concerned a Portuguese withholding tax on interest paid to nonresident financial institutions that was imposed on the gross amount of the interest paid, whereas resident financial institutions were (only) taxed on their net income.

While accepting that nonresident taxpayers might be subject to withholding taxes even if comparable residents pursuing the same activity were not, the CJEU held that the freedom to provide services²⁸⁸ prohibited nonresidents being taxed on gross income when comparable residents were taxed on net profits. Rather, Member States had to grant those nonresidents the same right to deduct actual expenses directly connected with the activity generating the income being taxed.²⁸⁹

Referencing its previous case law in *Gerritse*,²⁹⁰ *Conijn*,²⁹¹ and *Centro Equestre da Lezíria Grande*,²⁹² the Court repeated that resident and nonresident service providers were in a comparable situation in relation to the deduction of business expenses directly connected to the activity pursued.²⁹³

²⁸⁶ Case C-589/14, *Commission v. Belgium*.

²⁸⁷ Case C-18/15, *Brisal* — *KBC Finance Ireland*.

²⁸⁸ Both the CJEU decision and the Opinion of Advocate General Kokott are based on the freedom to provide services only. Arguably, the correct freedom under which the case ought to have been considered might have been the free movement of capital.

²⁸⁹ Thus, the CJEU in *Brisal* advocates the application of withholding tax to net interest rather than gross interest. This seems, at least conceptually, in conflict with OECD Model Tax Convention, Art. 11(2) of the in which the withholding tax limitation in the source State is expressed with reference to “the gross amount of the interest.” In her Opinion, Advocate General Kokott counters this perceived contradiction by stating that it cannot be inferred from the OECD Model Tax Convention that, in general, the source State should be obliged to tax gross income: “Article 11(2) of the OECD Model [Tax] Convention merely provides that the source State — in addition to the State in which the interest recipient is resident — may tax interest, albeit that this tax must not exceed a specific percentage of the gross amount of the interest. However, this merely sets a maximum amount as regards the outcome of the tax, and does not give the source State any instructions as regards taxation. On the contrary, it appears from the commentary on the OECD Model [Tax] Convention [namely, commentary on Article 11, paragraphs 7.1 and 7.7] that in precisely a case such as the present, in which interest payments are made to banks, many source States do not impose any tax.” (Opinion, paras. 60 and 61).

²⁹⁰ Case C-234/01, *Gerritse*.

²⁹¹ Case C-346/04, *Conijn*.

²⁹² Case C-345/04, *Centro Equestre da Lezíria Grande*.

²⁹³ The CJEU explicitly rejected the Portuguese government’s claim that financial services should be distinguished from other services based on the perceived impossibility of establishing any characteristic link between costs incurred and interest income received. The Court pointed out that the TFEU does not support such a distinction and that services provided by financial institutions cannot, as a matter of principle, be treated differently from the provision of services in other areas of activity. Relying on *Dijkman and Dijkman-Lavaleije* (Case C-233/09) and *X* (C-498/10), the Court repeated that “unfavorable tax treatment contrary to a fundamental freedom cannot be regarded as compatible with EU law because of the potential existence of other advantages,” specifically noting that the restriction at issue “cannot be justified by the fact that nonresident financial institutions are subject to a tax rate which is lower than the rate for resident financial institutions.”

In the CJEU’s view, business expenses directly related to the income received in the Member State in which the activity was pursued had to be understood as expenses occasioned by the activity in question, and therefore necessary for pursuing that activity.

Specifically, as regards the granting of loans, expenses meeting that criterion included:

(i) Specific expenses (insofar as deductions for such expenses were also granted to residents) such as:

(a) Travel and accommodation expenses;

(b) Legal advice;

(c) Tax advice; and

(ii) The attributable portion²⁹⁴ of general expenses or overheads including the fraction of the general expenses of the financial institution that might be regarded as necessary for the granting of a particular loan.²⁹⁵

NN (L),²⁹⁶ concerned the Belgian annual tax on undertakings for collective investment (UCIs) payable on the total, as of December 31 of the previous year, of the net amounts invested in Belgium.

In the event of the failure to file the annual declaration necessary for the recovery of the tax or the non-payment of that tax, Belgium imposed a specific penalty on UCIs governed by foreign law, namely a prohibition, ordered by a court, on making future investments of their units in Belgium.

The CJEU held this penalty to be incompatible with the freedom to provide services.

On February 24, 2022, the CJEU held in *Pharmacie populaire-La Sauvegarde v. Belgium*²⁹⁷ that a (former) administrative tolerance under Belgian law violated the freedom to provide services.

Broadly, the Belgian tax rules provided that taxpayers, who incurred expenses related to professional services received or commissions due, were subject to rather extensive administrative obligations (i.e., submission of detailed documentary evidence, including individual fee forms and summary statements). Companies not complying with these rules could be subject to a very onerous additional corporation tax levy, calculated as a percentage of the expenses incurred.

Under the said administrative tolerance, the obligation to provide such detailed documentary evidence in relation to certain service fees did not apply where the service provider was a company that:

(i) Issued an invoice in accordance with Belgian VAT legislation; and

(ii) Was subject to Belgian accounting law.

²⁹⁴ The Court explicitly refused the deduction of costs calculated on a notional basis, i.e., calculating the overheads by reference to indices such as those provided by Euribor or Libor.

²⁹⁵ It is significant that the scope of directly linked expenses for interest income in *Brisal* is significantly wider than that set forth by the CJEU in *Société Générale* (Case C-17/14) with respect to expenses directly linked to the receipt of dividends that may be taken into account by nonresidents (see 6.a., below).

²⁹⁶ Case C-48/15, *NN (L)*.

²⁹⁷ Joined Cases C-52/21 and C-53/21, *Pharmacie populaire — La Sauvegarde v. Belgium*.

Accordingly, the tolerance could not be applied where payments had been made to a foreign service provider.

The CJEU held that the difference in treatment was likely to deter Belgian companies from purchasing services from foreign service providers or impede opportunities for them to do so, and therefore, constituted a restriction on the freedom to provide services.

The Court dismissed the argument that the restriction was relatively minor (i.e., that it was a formal requirement, based on information that should be readily available in the accounts of the purchasing entity).

While the Court accepted that the effectiveness of fiscal supervision might constitute a valid ground for justifying the restriction, it emphasized that the measure went beyond what was necessary.

Given that accounting legislation and VAT were harmonized at the EU level, Belgian and foreign service providers were subject to similar obligations and, hence, the fee form requirement was not necessary for foreign tax authorities to be able to verify the taxable income of a service provider in its country.

The CJEU also dismissed the Belgian State's argument that the fee form obligation was necessary to facilitate the spontaneous and automatic exchange of the information provided with tax authorities of other Member States.

According to the Court, Belgium was not obliged to exchange such information in this way under the relevant legal instruments, and the tax authorities of other Member States were able to obtain the necessary information on request.

The Belgian Act of January 21, 2022, on miscellaneous tax provisions abolished the obligation to submit fee forms with respect to payments, made on or after January 1, 2021, to suppliers established in the EEA, provided there was a requirement to raise an invoice or an equivalent document. This ensured compliance with EU law for payments made as from that date.

In *Airbnb v. Italy*,²⁹⁸ the CJEU held that the imposition of:

(i) Data collection and reporting obligations on online platforms active in the short-term property rental sector; and

(ii) Withholding tax obligations on such platforms, were not prohibited by the EU law fundamental freedom to provide services, thus implying that Member States' tax authorities could use online platforms as a compliance arm for the "gig" economy.

As regards the withholding tax obligations, the Court relied on *Google Ireland*,²⁹⁹ in which it was held that the key test for establishing whether a restriction existed was whether:

- Provision of services between Member States had been rendered more difficult than rendering those services "purely within a Member State;" and
- The rules that had the effect of creating "additional costs" were not a restriction.

In contrast, Advocate General Szpunar had opined that the withholding tax obligations did amount to a restriction.

6. Free Movement of Capital

a. Outbound Dividends — Taxation of Nonresident Shareholders by Source State

(1) General Principles

It follows from the CJEU's decision in *Amurta*³⁰⁰ that the imposition of dividend withholding taxes in the source State — where dividends are paid from one Member State to another — is contrary to the free movement of capital if comparable domestic transactions are exempted from such taxes.

This decision is in line with the earlier judgment in *Denkavit Internationaal*,³⁰¹ decided under the freedom of establishment, where the CJEU confirmed that a State could not tax dividends paid to a nonresident parent company if an exemption applied to dividends paid to a resident parent company in a comparable situation.

This is, in turn, consistent with the ruling handed down in *ACT Group Litigation*,³⁰² in which the CJEU held that it was not discriminatory to:

(i) Grant a tax credit to residents; and

(ii) Not to grant one to nonresidents,

the reason being that the United Kingdom did not tax such nonresidents (unlike in the situation in *Denkavit Internationaal*, which concerned French tax rules), who were therefore not in a situation comparable to that of U.K. residents, who were taxed in the United Kingdom and consequently could utilize the tax credit.

Thus, a State is required to grant resident and nonresident beneficiaries of outbound dividends the same tax treatment only if that State taxes dividends paid to nonresidents.

The *Amurta* case law has been extended by:

(i) *Commission v. Netherlands*³⁰³ to cover dividends distributed from a Member State to an EEA-country; and

(ii) *Emerging Markets Series of DFA Investment Trust Company*³⁰⁴ to cover dividends distributed from a Member State to a third country.

(2) Withholding Tax on Dividend Payments to Nonresidents

In *Tate & Lyle Investments*,³⁰⁵ the CJEU held (by way of an order) that a Belgian withholding tax on dividends violated the free movement of capital principle if dividends paid to non-

³⁰⁰ Case C-379/05, *Amurta*; see also Case C-540/07, *Commission v. Italy* and Case C-487/08, *Commission v. Spain*.

³⁰¹ Case C-170/05, *Denkavit Internationaal*.

³⁰² Case C-374/04, *Test Claimants in Class IV of the ACT Group Litigation*. The Opinion of Advocate General Geelhoed had already made it clear that the principles applied in *Denkavit Internationaal* were to apply in the same way in the context of the free movement of capital provisions.

³⁰³ Case C-521/07, *Commission v. Netherlands*; see also, Case C-284/09, *Commission v. Germany*.

³⁰⁴ Case C-190/12, *Emerging Markets Series of DFA Investment Trust Company*.

³⁰⁵ Case C-384/11, *Tate & Lyle Investments* (Order of the Court).

²⁹⁸ Case C-83/21, *Airbnb Ireland and Airbnb Payments UK*.

²⁹⁹ Case C-482/18, *Google Ireland*.

resident corporate shareholders were economically (and thus covertly) subject to a higher tax burden than dividends paid to resident corporate shareholders.

The case concerned the Belgian participation exemption, which provided for a full exemption from withholding tax on dividends if the beneficiary was a qualifying company that held (or was committed to holding) at least 10% of the shares in the distributing company for at least one year.

However, because in the case at hand the main (nonresident) shareholder held only 5% of the company's shares, it did not qualify for the participation exemption. Hence, withholding tax was levied on the dividend.

Tate & Lyle Investments Ltd (TLI) argued that the Belgian rules violated the free movement of capital principle because they treated non-Belgian corporate shareholders significantly less favorably than Belgian corporate shareholders.

If TLI had been a Belgian resident company, it would have been able to offset the withholding tax against its final corporate tax liability.

In addition, Belgian corporate shareholders could qualify for the dividends received deduction (DRD), which excluded 95% of a dividend from the recipient's corporate tax base. As a result, only 5% of the dividend was taxed, resulting in an effective tax rate on the total dividend of approximately 1.7%.

If TLI had been a Belgian company, it would have qualified for the DRD because the acquisition value of its stake in Tate & Lyle Europe NV exceeded 1.2 million euros (increased to 2.4 million euros under current legislation), which was the (alternative) threshold for benefitting from the DRD (the other being a shareholding of at least 10%).

(3) Dividends Distributed by Portfolio Companies

In joined cases *Miljoen, X*, and *Société Générale*³⁰⁶ the CJEU held that Articles 63 and 65 of the TFEU had to be interpreted as precluding legislation of a Member State (in the cases at hand, the Netherlands) that imposed a withholding tax on dividends on portfolio investments paid by a resident company and provided a mechanism for deducting or reimbursing the tax withheld only for resident taxpayers, to the extent the final tax burden for nonresident taxpayers was greater than that borne by resident taxpayers (as tax withheld was a final tax), unless the potential discriminating taxation in the source state (i.e., the Netherlands) could be removed by a tax treaty, but only when the difference in tax treatment of the dividend income was fully neutralized.

(4) Basis of Comparison

The CJEU held that the comparison of the tax burden between a resident and nonresident should be performed on a net basis, i.e., for the purposes of determining those tax burdens, account had to be taken of the taxation of residents in relation to:

- (i) In *Miljoen* and *X*: All shares held in Dutch companies in the calendar year and capital that was exempt from tax under national legislation; and

- (ii) In *Société Générale*: Expenses directly linked to the actual payment of the dividends.

As to the latter expenses, the CJEU specified that:

- Neither the part of the purchase price of the shares that represented an upcoming dividend (which could be deducted when calculating the taxable base, and thus effectively eliminate tax on the dividend);
- Nor financing costs,

both of which concerned ownership of shares as such, were “directly linked” to the actual dividends from those shares. Such items were therefore excluded when comparing the effective tax burden imposed on residents and³⁰⁷

In *Pensioenfond Metaal en Techniek*,³⁰⁸ the CJEU held that Swedish legislation under which dividends distributed by a resident company to a nonresident pension fund were subject to a tax levied at source, while dividends paid to a resident pension fund were subject to a lump-sum tax on a notional yield that, over time, was intended to correspond to the normal taxation of all yields on capital under the general law regime, was compatible with Article 63 of the TFEU.

According to the Court, the neutrality of taxation with respect to the type of investment sought by the legislation at issue presupposed the taxation of the whole of the taxpayer's investment portfolio, whatever the make-up of the taxpayer's investment portfolio, an aim that could not be achieved in the case of a nonresident pension fund, which was subject to Swedish taxation only on income having its source in Sweden.

In other words, a nonresident pension fund was considered to not be in a situation comparable to that of a resident pension fund in light of:

- The aim pursued by the national legislation concerned; and
- The purpose and content of that legislation,

The Court added, however, referring to the *Miljoen* case,³⁰⁹ that if the taxation method applied to resident pension funds, as to the calculation of the tax base of those funds and, in particular, the inclusion of their liabilities in the calculation of the capital base, allowed any professional expenses directly connected to the receipt of dividends to be taken into account (which was a matter for the referring court to ascertain), it should also be admissible to take into consideration such expenses in the case of nonresident pension funds.

(5) Dividends Distributed to Collective Investment Vehicles

At issue in *AllianzGI-Fonds AEVN*³¹⁰ was a Portuguese tax provision treating dividends distributed to a UCITS formed under Portuguese law as exempt from corporate income tax, while the exemption was not available to foreign-based UCITS.

³⁰⁷ Compare with the significantly wider scope of directly linked expenses for interest income that the CJEU retained in Case C-18/15, *Brisal — KBC Finance Ireland* (see 5., above).

³⁰⁸ Case C-252/14, *Pensioenfond Metaal en Techniek*.

³⁰⁹ Joined Cases C-10/14, C-14/14 and C-17/14, *Miljoen, X* and *Société Générale*.

³¹⁰ Case C-545/19, *AllianzGI-Fonds AEVN*.

³⁰⁶ Joined Cases C-10/14, C-14/14 and C-17/14, *Miljoen, X* and *Société Générale*.

The CJEU held that Article 63 of the TFEU precluded tax rules such as those at issue, which provided for a withholding to be made, in full discharge of liability, from dividends distributed by Portuguese companies and received by UCITS not resident in Portugal and established in other Member States, whereas collective investment undertakings formed under Portuguese tax law and resident for tax purposes in Portugal could benefit from an exemption from such withholding.

The Court's ruling goes against the views expressed by Advocate General Kokott who, on May 6, 2021, had opined that the difference in the Portuguese tax treatment of resident and nonresident entities that were UCITS within the meaning of the Directive 2009/65/EC (on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (recast)) was not contrary to EU law.

According to the Advocate General, a taxpayer that held only a minor part of its assets in a Member State other than its jurisdiction of residence was generally not in a situation comparable to that of a resident of that other Member State.

Therefore, the situations of resident and nonresident UCITS were not comparable.

The Advocate General added that, even if the CJEU were to deem the situation of a resident UCITS and nonresident UCITS to be comparable, a difference in tax treatment could still be justified based on overriding reasons of public interest, such as:

- (i) Achieving a balanced allocation of taxing powers;
- (ii) Combatting tax avoidance; or
- (iii) Achieving fiscal cohesion.

Finally, the Advocate General determined that the taxing mechanisms adopted by Portugal would be proportionate to achieve these aims.

(6) *Conditions Imposed on Repayment of Withheld Tax*

*ACC Silicones*³¹¹ addressed the issue of whether German legislation imposing stricter conditions on nonresident entities wishing to obtain reimbursement of the tax paid on dividends from "free-float" shares was contrary to the free movement of capital principle.

The CJEU held that Article 63 of the TFEU had to be interpreted as precluding a provision of a Member State's tax legislation that made the reimbursement of tax on income from capital paid on dividends from shareholdings below the thresholds laid down by Parent-Subsidiary Tax Directive and received by a company established in another Member State subject to proof that the tax could not be:

- Set off, or carried forward and set-off, in favor of that company, or in favor of its direct or indirect shareholders; or
- Deducted by that company as work-related outgoings or operating cost,

when these conditions did not have to be met as regards reimbursement of tax on income from capital paid by a resident company receiving the same type of income.

In the Court's opinion, the resulting restriction on the free movement of capital was not justifiable either by:

- (i) The objective of safeguarding the balanced allocation of the right to tax between the Member States; or
- (ii) The need to avoid a withholding tax being taken into account twice.

(7) *Dividends Paid to Exempt Pension Funds*

*Keva*³¹² concerned a Swedish tax provision under which dividends distributed by Swedish resident companies to nonresident pension institutions governed by public law were subject to a withholding tax, but dividends distributed to Swedish resident pension funds governed by public law were exempt from the withholding tax. After noting that the provisions relating to the free movement of capital do not draw a distinction between private undertakings and public undertakings and, hence, do not exclude the public sector from their scope, the CJEU found the Swedish provision at issue to be incompatible with the free movement of capital.

In the Court's view, the restriction could not be justified in the light of the need to safeguard the objective pursued by Swedish social policy and its financing, nor by the principle of territoriality combined with the need to preserve a balanced allocation of the powers between the Member States as regards the general income-based old-age pension scheme.

The CJEU also dismissed the Swedish Government's argument to the effect that the principle of non-discrimination, within the meaning of Article 24 of the OECD Model Tax Convention, does not mean that a State granting special tax advantages to its own public bodies is required to grant the same advantages to public bodies of another State; this is apparent from paragraphs 10 and 12 of the Commentary on Article 24. In the Court's opinion, a Member State cannot rely on those paragraphs for purposes of avoiding its obligations under the Treaty. The Court added that, although it is common ground that EU law respects the power of the Member States to organize their social security systems, the fact remains that, when exercising that power, the Member States must comply with EU law and, in particular, with the provisions of the TFEU relating to the fundamental freedoms.

*XX*³¹³ concerned a UK-based life insurance undertaking that received dividend payments from Dutch companies in the context of its "unit-linked" insurance contracts. For resident taxpayers, Dutch dividend withholding tax acts as an advance levy on corporate income tax. The tax paid on dividends can be fully offset against their corporate income tax liability, with any excess refunded. This means resident investors subject to corporate income tax are taxed only on the net income from their investments after deducting certain costs. In contrast, nonresident taxpayers are subjected to a 15% withholding tax on the gross amount, which typically serves as a final levy. The CJEU ruled that the Dutch legislation at issue constitutes a re-

³¹¹ Case C-572/20, *ACC Silicones*.

³¹² Case C-39/23, *Keva*.

³¹³ Case C-782/22, *XX*.

striction on the free movement of capital that cannot be justified by an overriding reason of public interest.

In *Credit Suisse Securities*,³¹⁴ the CJEU found Spanish withholding tax rules (applicable at the time) treating the withholding tax on dividends as a prepayment of corporate income tax for resident companies (that could be reimbursed in the event of tax losses), but as a final levy for nonresident companies in similar circumstances, to constitute an unjustifiable restriction on the free movement of capital. Referring to *Sofina and Others*,³¹⁵ the Court reasoned that the withholding tax rules at issue were liable to confer an advantage on loss-making resident companies, since they give rise, at the very least, to a cash-flow advantage, or even an exemption, whereas nonresident companies are subject to immediate and definitive taxation irrespective of their results. The Court rejected the effective collection of tax, the balanced allocation of the power of taxation between Member States and the prevention of the risk of losses being used twice as overriding reasons in the public interest, justifying the discrimination at issue.

b. Inbound Dividends — Taxation of Shareholders in Residence State

The recurring theme in the CJEU's case law on inbound dividends has been the compatibility (or otherwise) with the free movement of capital of different rules or methods for relieving double taxation in domestic and cross-border situations with respect to inbound dividends received by a resident shareholder.

In particular, the Court repeatedly considered the issue of whether it was possible to apply rules or methods to dividends sourced in other Member States, EEA States and third countries that were different from those that applied in purely domestic situations.³¹⁶

In *Verkooijen*,³¹⁷ a Dutch legislative provision making the granting of an exemption from income tax payable on dividends paid to natural person shareholders conditional on such dividends being paid by a company with its seat in the Netherlands was found to be incompatible with the free movement of capital.

Similarly, in *Manninen*,³¹⁸ the CJEU held that the denial of a credit with respect to dividends received from other Member States constituted a restriction on the free movement of capital principle.

³¹⁴ Case C-601/23, *Credit Suisse Securities*.

³¹⁵ Case C-575/17, *Sofina and Others*.

³¹⁶ It is worth repeating that the situation of shareholders must be appreciated from the perspective of the freedom of establishment, rather than from that of the free movement of capital, where their holding gives them definite influence over the company's decisions and allows them to determine its activities. However, a Member State's national rules relating to the tax treatment of dividends from a third country that do not apply exclusively to situations in which the parent company exercises decisive influence over the company paying the dividends must be assessed in light of the Treaty provisions on the free movement of capital. A company resident in a Member State may, therefore, rely on those provisions to call into question the legality of such rules, irrespective of the size of its shareholding in the company paying dividends established in a third country (Case C-35/11, *Test Claimants in the FII Group Litigation*). See A., above.

³¹⁷ Case C-35/98, *Verkooijen*.

³¹⁸ Case C-319/02, *Manninen*.

In the same vein, in *Meilicke*,³¹⁹ the CJEU concluded that, in calculating the amount of the tax credit to which a shareholder who was fully taxable in a Member State with regard to dividends paid by a capital company established in another Member State was entitled, the free movement of capital principle precluded the application of a national provision under which corporation tax imposed on dividends of foreign origin was set off against a shareholder's income tax only to the extent of the percentage of corporation tax imposed on gross dividends distributed by companies in the first Member State.

In *Kerckhaert-Morres*,³²⁰ (admittedly, a controversial case in that it appears to deviate from the Court's decisions in *Verkooijen* and *Manninen*), the CJEU found that Belgian income tax legislation that made dividends on shares in companies established in Belgium and dividends on shares in companies established in another Member State subject to the same uniform rate of tax, without providing for the possibility of setting off tax levied by deduction at source in that other Member State, did not restrict the free movement of capital.

The Court's reasoning was that the adverse consequences that might arise from the application of an income tax system, such as the Belgian tax system at issue, resulted from the exercise, in parallel, by two Member States of their fiscal sovereignty.

The CJEU held that EU law, as it then stood, in a situation such as that at issue, did not lay down any general criteria for the attribution of areas of competence between the Member States in relation to the elimination of double taxation within the European Union.

In *Damseaux*,³²¹ a Belgian resident received dividends from a French listed company.

Those dividends were initially subject to a 25% withholding tax in France.

Under Article 15(2) of the France-Belgium tax treaty, Mr. Damseaux was able to request the reimbursement of part of that withholding tax, resulting in the dividends being subject, in France, only to a 15% withholding tax.

The amount remaining following the imposition of that tax was also subject to a 15% income tax levied by way of withholding in Belgium.

Mr. Damseaux took the position that his French dividends were taxed at a higher rate than Belgian dividends and that, given that Belgium had accepted that France would impose a withholding tax, as the Member State of residence, Belgium should have either allowed the French withholding tax to be credited against the Belgian withholding tax or waived the withholding tax to avoid double taxation.

The Belgian tax authorities disagreed.

The CJEU noted that it did not have jurisdiction either to:

- Rule on a possible infringement by a contracting Member State of provisions of bilateral conventions entered into by the Member States and designed to eliminate or to mitigate the negative effects of the coexistence of national tax regimes; or

³¹⁹ Case C-292/04, *Meilicke*.

³²⁰ Case C-513/04, *Kerckhaert-Morres*.

³²¹ Case C-128/08, *Damseaux*.

- Examine the relationship between a national measure and the provisions of a double taxation agreement,

since such matters did not fall within the scope of the interpretation of Community law.

The Court concluded that, in such circumstances, the free movement of capital did not preclude a bilateral tax convention:

- Under which dividends distributed by a company established in one Member State to a shareholder residing in another Member State were subject to tax in both Member States; and
- Which did not provide that the Member State in which the shareholder resided was unconditionally obliged to prevent any resulting juridical double taxation.

On the other hand, in *Commission v. Spain*,³²² Spain was found to discriminate against nonresident shareholdings by making an exemption from the taxation of dividends dependent on the meeting of a shareholding requirement that was higher for holdings in nonresident companies than it was for holdings in Spanish resident companies.

In *A*,³²³ the Court considered that the freedom of capital movement was restricted by Swedish legislation that exempted a shareholder from tax with respect to certain dividends, provided the distributing company was established in an EEA State or a third State with which Sweden had concluded a tax treaty providing for the exchange of information. Nevertheless, the national provision at issue was considered justified because, in the case of third countries, a Member State could not verify with the same degree of reliability that the conditions for the granting of the exemption were met as it could in intra-EU cases.

*Orange European Smallcap Fund*³²⁴ concerned the legislation of a Member State (the Netherlands) under which a concession granted to a fiscal investment enterprise established in that Member State on account of tax deducted at source in another Member State from dividends received by that fiscal investment enterprise was restricted to the amount that a natural person resident in the first Member State could have had credited based on a tax treaty concluded with the same other Member State.

According to the CJEU, such legislation was not prohibited under the free movement of capital principle.

By contrast, the free movement of capital precluded legislation of a Member State that:

- Granted a concession to fiscal investment enterprises established in that Member State on account of tax deducted at source in another Member State or third country from dividends received by those enterprises; and
- Reduced that concession where, and to the extent that, the shareholders of those enterprises were natural or legal persons resident or established in other Member States or in third countries, since such a reduction adversely affect-

ed all the shareholders of those enterprises without distinction.

While it cannot be denied that the use of different methods for relieving double taxation usually gives rise to a cash-flow disadvantage, in *Franked Investment Income GLO I*,³²⁵ the CJEU's position appears to be that different methods can be used insofar as they reach an equivalent result.

Since assessment of equivalence is a factual matter, it is for the national court to ascertain it.

This was confirmed in joined cases *Haribo* and *Österreichische Salinen*³²⁶ where the CJEU's interpretation of the free movement of capital would seem to allow the Member States to:

- Differentiate between the tax treatment applicable domestically and that applicable in cross-border situations, thus in fact endorsing measures applicable at the level at which relief was provided; and
- Pursue capital export neutrality at national level,

which might, to some extent, dissuade taxpayers from exercising fundamental freedoms.

It follows from the above discussion, therefore, that where internal dividends are exempt, taxation of foreign dividends is allowable provided the tax paid in the State in which the distributing company is resident is credited against the tax payable in the Member State of the recipient and the administrative burdens imposed on the recipient to enable it to qualify for such a credit are not excessive.

By applying a tax regime for dividends from abroad that is less favorable than the regime applied to domestic dividends, a Member State fails to fulfill its obligations under the freedom of establishment and the free movement of capital principle and the corresponding provisions of the EEA Agreement.³²⁷

As such, the statement of the CJEU in *Cobelfret*³²⁸ that exemption and imputation in the case of shareholders receiving dividends did not necessarily lead to the same result is somewhat ambiguous.

At issue in *Accor*³²⁹ was French legislation intended to eliminate the economic double taxation of dividends by allowing a parent company to set off against the advance payment for which it was liable, when redistributing to its shareholders dividends paid to it by a subsidiary, the tax credit applied on the

³²² Case C-487/08, *Commission v. Spain*.

³²³ Case C-101/05, *A*.

³²⁴ Case C-194/06, *Orange Smallcap Fund*.

³²⁵ Case C-446/04, *Test Claimants in the FII Group Litigation*.

³²⁶ Joined Cases C-436/08 and C-437/08, *Haribo* and *Österreichische Salinen*.

³²⁷ Case C-406/07, *Commission v. Hellenic Republic*.

³²⁸ Case C-138/07, *Cobelfret*.

³²⁹ Case C-310/09, *Accor*. See also Case C-416/17, *Commission v France* concerning the same issue. In that ruling, the CJEU also found that a court or tribunal against whose decisions there is no judicial remedy under national law (in the case at issue, the French *Conseil d'État*) is legally required to submit a preliminary question to the CJEU to avert the risk of an incorrect interpretation of EU law. That obligation does not apply, by way of exception, when the national court or tribunal finds that the question raised is irrelevant, that the provision of EU law in question has already been interpreted by the Court (*acte éclairé*), or that the correct application of EU law is so obvious as to leave no scope for any reasonable doubt (*acte clair*) — see for these exceptions: Case 283/81, *CILFIT* (setting out the criteria for determining the scope of discretion of national courts of last resort when deciding to make a preliminary reference under TFEU, Art. 267).

distribution of those dividends if they originated from a subsidiary established in France.

The legislation did not offer the same option if the dividends originated from a subsidiary established in another Member State, since, in that case, the legislation did not provide for an entitlement to a tax credit applied on the distribution of those dividends by such a subsidiary.

In line with its earlier case law, the CJEU found the legislation to be contrary to the freedom of establishment and the free movement of capital principle.

The Court further held that, provided the tax payable by the taxpayer was not passed on to a third party (in the case at hand, the advance payment due from Accor had not been passed on to its shareholders), a Member State could not, based on arguments of unjust enrichment, refuse to reimburse the taxpayer in such circumstances.

The same held true if the amounts paid represented a charge against amounts distributable to shareholders rather than a charge on the company itself.

Finally, the CJEU ruled that the principles of equivalence and effectiveness did not prevent Member States from making a refund of tax paid under a discriminatory regime conditional on the taxpayer providing evidence, unless such evidence proved virtually impossible or excessively difficult to obtain.

According to the Court, tax authorities had to be in a position to satisfy themselves as to the amount of corporate tax paid in another Member State to ensure that an equivalent tax credit was granted for dividends received from that other State.

*Kronos International*³³⁰ concerned the denial of a tax credit/refund with respect to foreign dividends under the former German corporate tax imputation system.

Domestic dividends received by a German resident corporate taxpayer were fully taxable in Germany until 2001.

A certain amount of corporate tax paid by the subsidiary distributing the dividends was credited/refunded at the level of the parent company.

As foreign dividends were exempted, subject to certain conditions (for example, that the German parent held a participation of at least 10% in the foreign subsidiary), no credit/refund of foreign corporate tax was available.

According to the CJEU:

- The refusal to grant a refund; and
- The difference in treatment

could be explained by an objective difference in situation as, with regard to the refund of the tax paid by the company distributing the dividends, a company receiving foreign-sourced dividend was not in a situation comparable to that of a company receiving domestically-sourced dividends.

The free movement of capital principle enshrined in Article 63(1) of the TFEU could not have the effect of requiring Member States to go beyond:

- (i) The cancelling of national income tax payable by a shareholder with respect to foreign-sourced dividends received; and

- (ii) Reimbursing a sum originating in the tax system of another Member State,³³¹

if the first Member State was not to see its fiscal autonomy limited by the exercise of the fiscal power of the other Member State.

A Member State's status as the State of residence of a company receiving dividends could not entail an obligation for that Member State to offset a fiscal disadvantage arising where a series of charges to tax was imposed entirely by the Member State in which the company distributing the dividends was established, insofar as the dividends received were neither taxed nor taken into account in a different way by the first Member State as regards investment enterprises established in that State.

Consequently, in a situation where the Member State did not exercise its powers of taxation over the incoming dividends — either by taxing them or by taking them into account in another way — as regards the company receiving them, its obligations, as the Member State of residence of the company receiving the dividends, did not go so far as to require it to offset the tax burden resulting from the exercise of the taxing powers of another Member State or a third State.

Accordingly, Article 63 of the TFEU had to be interpreted as not precluding the application of the exemption method to dividends distributed by companies resident in other Member States and in third States, when the imputation method was applied to dividends distributed by companies resident in the same Member State as the company receiving them.

If the latter company recorded losses, the imputation method resulted in the tax paid by the resident company that made the distribution being fully or partially refunded.

In *Baudinet and Others*,³³² the CJEU held that Articles 49, 63 and 65 of the TFEU did not preclude legislation of a Member State that did not remedy the double taxation resulting from the simultaneous exercise of tax jurisdiction by two Member States, i.e., when a resident of a Member State that was a shareholder in a company established in another Member State received from that company dividends taxed in both States, the resulting double taxation was not remedied by the grant under the legislation of the shareholder's State of residence of a tax credit at least equal to the amount of tax paid in the State of the source of those dividends.

According to the Court, the residence Member State was not required, under EU law as it then stood, to compensate a tax disadvantage resulting from the simultaneous exercise of tax jurisdiction by both Member States.

In *SECIL*,³³³ the CJEU clarified the scope of the free movement of capital principle in third-country situations.

At issue was Portugal's tax treatment of dividends from third-country subsidiaries.

SECIL, a Portuguese company, had major shareholdings in companies resident in the following jurisdictions:

- (i) Lebanon (direct holding of 28.64%); and
- (ii) Tunisia (direct holding of 98.72%).

³³¹ See the analogy with Case C-35/11, *Test Claimants in the FII Group Litigation*.

³³² Case C-194/15, *Baudinet and Others* (Order of the Court).

³³³ Case 464/14, *SECIL*.

³³⁰ Case 47/12, *Kronos International*.

The dividends received by SECIL from those subsidiaries were fully taxed in Portugal.

The question arose whether, given the full or partial deduction available for domestic dividends, such taxation violated either:

- (i) The Treaty provisions on the free movement of capital (Articles 63 to 65 of the TFEU); or
- (ii) The Euro-Mediterranean Agreements with Lebanon and Tunisia, respectively.

Both agreements were concluded by the EU and the Member States (including Portugal) and contained:

- (i) Provisions on establishment and capital movement; as well as
- (ii) Certain tax carve-outs (Articles 31, 33 and 85 and Articles 31, 34 and 89, respectively).

As the Portuguese legislation at issue was not intended to apply exclusively to situations in which the recipient company had a decisive influence over the distributing company, the CJEU considered Article 63 to be applicable.

The Court found that legislation to amount to a restriction on free movement of capital, as the Portuguese rules clearly distinguished between domestic dividends (full or partial deductibility) and comparable third-country dividends (full taxation).

In *Trustees of the BT Pension Scheme*,³³⁴ the trustees of the BT Pension Scheme (BTPS) and numerous other pension schemes argued that a legislative regime the United Kingdom had in place between 1994 and 1999 breached EU law in not providing payable tax credits with respect to foreign income dividends (FIDs) paid by U.K. companies.

The CJEU confirmed that shareholders receiving FIDs were entitled to the same treatment as those receiving U.K.-sourced dividends and, hence, should be given an effective remedy, enabling them to obtain payment of the tax credits of which they had been deprived.

The Court added that the fact that the BT PS was not subject to income tax and that some companies may have chosen to pay higher dividends to shareholders that were unable to recover tax credits did not alter its decision.

c. Capital Gains on Shares and Other Assets

In *Commission v. Spain*,³³⁵ the Spanish tax system under which capital gains on shares listed on foreign stock exchanges were taxable, unlike capital gains on shares listed on Spanish stock exchanges, was held to be incompatible with the free movement of capital.

In a subsequent case,³³⁶ the Spanish tax system was also considered to be in conflict with that freedom to the extent the rate of tax on the capital gains of nonresidents was higher than on those of residents.

In *Grønfeldt*,³³⁷ the CJEU held that Article 63 of the TFEU precluded legislation of a Member State under which profits on

a 2001 sale of shares in a limited company established in another Member State were immediately taxable where the seller had held, either directly or indirectly, at least 1% of the company's capital within the previous five years, while profits on a 2001 sale, in the same circumstances, of shares in a limited company established in that first Member State and subject to unlimited corporation tax in that State, were subject to tax only where the shares represented a substantial shareholding of at least 10%.

At issue in *De Baeck*³³⁸ was Belgian tax legislation treating as miscellaneous income (taxable at the rate of 33%) the gain in value secured on a transfer for valuable consideration to a non-resident company, otherwise than in the context of the exercise of a business activity, of shares or stock in:

- (i) A company;
 - (ii) An association;
 - (iii) An establishment; or
 - (iv) A body having its company seat, main establishment or center of management or operations in Belgium,
- where the transferor (or, if the shares were not obtained for valuable consideration, the transferor's predecessor in title), at any time in the period of five years preceding the transfer, alone or together with his/her:
- (i) Spouse;
 - (ii) Descendants;
 - (iii) Ascendants;
 - (iv) Relatives in the second degree; and
 - (v) Relatives of his/her spouse,

directly or indirectly held more than 25% of the rights in the company in which the shares or stock were transferred.

However, such a gain was not chargeable to tax if it was secured on the transfer of shares or stock to a resident company.

The CJEU found this difference in treatment to be contrary to the freedom of establishment if the seller's holding conferred on him influence in the management of the company, etc. whose shares or stock were transferred.

Where this was not the case, the difference was contrary to the free movement of capital.

*Bouanich*³³⁹ concerned the consequences for a French resident shareholder of the redemption by a Swedish company of its own shares.

Under Swedish tax law, the income generated by such a redemption when derived by a Swedish resident taxpayer qualified as capital gains taxable at the rate of 30% after deduction of the acquisition cost of the shares.

The same income was characterized as a dividend taxable without any deduction when derived by a nonresident taxpayer.

The CJEU found this treatment to be incompatible with the free movement of capital.

However, because, under the terms of the Sweden-France tax treaty, a French resident in these circumstances was:

³³⁴ Case C-628/15, *Trustees of the BT Pension Scheme*.

³³⁵ Case C-219/03, *Commission v. Spain*.

³³⁶ Case C-562/07, *Commission v. Spain*.

³³⁷ Case C-436/06, *Grønfeldt*.

³³⁸ Case C-268/03, *De Baeck*.

³³⁹ Case C-265/04, *Bouanich*.

- Allowed to deduct from the price received the nominal value of the redeemed shares; and
- Taxed at the rate of 15% on the difference,

the Court acknowledged that the treaty had to be taken into account and left it for the national judge to determine, in the view of both:

- The cost of acquisition; and
- The nominal value of the shares,

whether equality was thus reinstated.

The case *Commission v. United Kingdom*³⁴⁰ involved U.K. tax legislation concerning the attribution of gains to participants in nonresident companies that provided for a difference in treatment between domestic and cross-border activities.

According to the CJEU, the legislation was not confined to specifically targeting wholly artificial arrangements that did not reflect economic reality and were carried out for tax purposes alone, but also affected conduct whose economic reality could not be disputed.

The legislation applied generally to gains made on the disposal of assets by non-U.K. resident companies controlled by no more than five persons (“close companies,”) in particular, without taking into account whether the taxpayer resident in the United Kingdom to whom the gain resulting from such a disposal was to be attributed was one of those persons.

There were only a few circumstances in which the legislation did not apply, such as the disposal of an asset used exclusively for the purposes of a trade carried on by the company outside the United Kingdom.

Furthermore, the legislation did not allow the taxpayer concerned to provide evidence to show the economic reality of his/her participation in the company in question.

According to the CJEU, therefore, the legislation went beyond what was necessary to achieve its objective.

Consequently, the United Kingdom was held to have failed to fulfill its obligations under:

- Article 63 of the TFEU; and
- Article 40 of the Agreement on the European Economic Area.

See, also, II.E.4.f., above, with regard to exit taxes.

d. Immovable Property

At issue in *Barbier*³⁴¹ was Dutch legislation concerning the assessment of tax due on the inheritance of immovable property situated in the Netherlands under which, in assessing the value of the property, the fact that the deceased was under an unconditional obligation to transfer legal title to another person having financial ownership of that property could be taken into account if, at the time of death, the deceased had resided in the Netherlands, but could not be taken into account if the deceased had resided in another Member State.

According to the CJEU, such national provisions had the effect of restricting the free movement of capital.

*D*³⁴² concerned Dutch wealth tax legislation limiting a tax allowance to residents only.

10% of the wealth of Mr. D., a German resident, consisted of real property situated in the Netherlands, the remainder being held in Germany.

Mr. D. was liable to wealth tax as a nonresident taxpayer, without, however, being entitled to the tax allowance available to resident taxpayers.

According to the CJEU:

- The different treatment of residents and nonresidents by a Member State in which the person concerned held only 10% of his wealth; and
- The lack of an allowance in that case

could be explained by the fact that the person concerned held only a minor part of his wealth in that State and that he was accordingly not in a situation comparable to that of a resident of that State.

Since the taxpayer held the major part of his wealth in the State in which he was resident, the Member State in which he held only a small proportion of his wealth was not required to grant him the benefits that it granted to its own residents. See also II.E.3.b., above.

At issue in *ELISA*³⁴³ was French legislation exempting a company established in France from the tax on the commercial value of immovable property owned in France by a legal person.

In the case of a company established in another Member State, the legislation made the exemption dependent on the existence of either:

- A convention on administrative assistance between France and that State for the purposes of combating tax avoidance and tax evasion; or
- A requirement in a tax treaty containing a clause prohibiting discrimination on the grounds of nationality to the effect that such a company could not be more heavily taxed than a company established in France.

The legislation also did not allow a company established in another Member State to supply evidence to establish the identity of the natural persons who were its shareholders.

The legislation was therefore held to be incompatible with the free movement of capital principle.

A similar case (albeit in an EEA context) was *Rimbaud*,³⁴⁴ which concerned an exemption from the tax on the market value of immovable property located in France available to a company that had its seat in the territory of a Member State, but making that exemption conditional, in the case of a company that had its seat in the territory of an EEA country that was not a Member State, on either:

- The existence of a convention on administrative assistance between the Member State and the non-Member State for the purposes of combating tax evasion and tax avoidance; or

³⁴² Case C-376/03, *D*.

³⁴³ Case C-451/05, *ELISA*.

³⁴⁴ Case C-72/09, *Rimbaud* (Rimbaud had its seat in Liechtenstein and owned immovable property in France).

³⁴⁰ Case C-112/14, *Commission v. United Kingdom*.

³⁴¹ Case C-364/01, *Barbier*.

(ii) The fact that, under a tax treaty containing a clause prohibiting discrimination on the grounds of nationality, such a company could not be taxed more heavily than a company established in France.

The CJEU held that the provisions concerned, while restricting the free movement of capital (provided for in Article 40 of the EEA Agreement), were justified by:

- (i) The need to combat tax evasion; and
- (ii) The need to safeguard the effectiveness of fiscal supervision (see, in the same vein, *Prunus*,³⁴⁵ regarding companies with their registered offices in an OCT).

In *Jäger*,³⁴⁶ the CJEU addressed German legislation providing that, for the purposes of calculating the tax on an inheritance consisting of:

- (i) Assets situated in Germany; and
- (ii) Agricultural land and forestry situated in another Member State,

account had to be taken of the fair market value of the assets situated in the other Member State, while a special valuation procedure existed for identical domestic assets (resulting, on average, in the inclusion of only 10% of the fair market value of those assets).

The legislation also confined the application of a tax-free amount to domestic agricultural land and forestry and took into account only 60% of the remaining value of such land/forestry.

In the CJEU's view, the difference in the amount of tax payable according to whether an inheritance consisted only of agricultural land and forestry situated in Germany or consisted also of such assets situated in another Member State, could not be justified on the grounds that the situations concerned were not objectively comparable.

The calculation of the tax was, under the national legislation at issue, directly linked to the value of the assets included in the estate, with the result that there was no objective difference in the situations such as to justify unequal tax treatment insofar as the level of inheritance tax payable in relation to, respectively, an asset situated in Germany and an asset situated in another Member State was concerned.

A situation such as that of Mr. Jäger was therefore comparable to that of any other heir whose inheritance consisted only of agricultural land and forestry situated in Germany bequeathed by a person domiciled in that State.

In *Hollmann*,³⁴⁷ the CJEU held that Article 63 of the TFEU had to be interpreted as precluding national legislation that subjected capital gains resulting from the transfer of immovable property situated in a Member State, where the transfer was made by a resident of another Member State, to a tax burden greater than that which was applicable, in the case of the same type of transaction, to capital gains realized by a resident of the State in which the immovable property was situated.

*K*³⁴⁸ concerned a Finnish resident individual who claimed a deduction for capital losses arising from the sale of real property in France.

Under the Finnish legislation concerned, a capital loss arising from the sale of an asset (including real property) could be deducted against capital gains arising from the sale of other assets.

However, in the case of real property located in France, the combined application of:

- The Finland-France tax treaty; and
- The Finnish legislation for the relief of international double taxation

had the effect that income from real property was only taxed in the Contracting State in which the property was located.

Thus, under the principle of symmetry, losses on the sale of real property located in France were not deductible in Finland.

Following the sale of the French real property, K. no longer had a source of income in France from which he could deduct the loss in question.

He therefore argued that, since he had exhausted the possibilities of using the losses in France, the "no possibilities" test set forth in *Marks & Spencer* (see II.E.4.b., above) applied.

According to the CJEU, however, K. could not be regarded as having exhausted the possibilities available in the Member State in which the property was situated of having the losses taken into account, because that Member State did not provide for the possibility of losses incurred on the sale of the property being taken into account and that, consequently, such a possibility had never existed.

In the Court's view, if it were accepted that the Member State in which the taxpayer resided had to nevertheless allow losses on immovable property to be deducted from taxable profits in that Member State, that would effectively oblige the latter to bear the adverse consequences arising from the application of the tax legislation adopted by the Member State in which the property was situated.

The CJEU concluded that the free movement of capital principle could not be understood as meaning that a Member State was required to adjust its tax rules based on those of another Member State to ensure, in all circumstances, tax treatment that removed any disparities arising from the application of national tax rules, given that the decisions made by a taxpayer as to investing abroad might be to the taxpayer's advantage or not, according to circumstances.

In *Verest and Gerards*,³⁴⁹ the CJEU held that Article 63 of the TFEU precluded legislation of a Member State insofar as it was liable to lead, when a progressivity clause contained in a tax treaty was applied, to a higher rate of tax on income merely because the method for determining income from immovable property resulted in income deriving from immovable property situated in another Member State that was not rented out being assessed at a higher rate than income from such property situated in the first Member State. It was for the referring court to

³⁴⁵ Case C-384/09, *Prunus*; see also A., above.

³⁴⁶ Case C-256/06, *Jäger*.

³⁴⁷ Case C-443/06, *Hollman*.

³⁴⁸ Case C-322/11, *K*.

³⁴⁹ Case C-489/13, *Verest and Gerards*.

ascertain whether that was in fact the effect of the legislation in question.

*XG v. Autoridade Tributaria e Aduaneira*³⁵⁰ involved a Portuguese national (XG) who was resident in the United States and sold inherited real estate located in Portugal.

As a consequence of the sale, the taxpayer was taxed under a specific capital gains tax regime that was more onerous than the regime applicable to Portuguese residents (who benefitted from a 50% reduction in the tax base for calculating personal income tax on such capital gains).

The CJEU held that Articles 63 and 65(1) of the TFEU had to be interpreted as precluding legislation of a Member State relating to personal income tax that made capital gains arising from the sale by a resident of a third country of immovable property situated in that Member State subject to a higher tax liability than that which would apply to capital gains with respect to the same type of transaction derived by a resident of that Member State.

At issue in *Commission v. Spain*,³⁵¹ was a Spanish tax provision requiring Spanish resident taxpayers to provide to the Spanish tax authorities information relating to immovable property and rights held with respect to immovable property owned by them and situated abroad.

Failure to comply with, or partial or late compliance with, the obligation to provide such information resulted in:

- The taxation of undeclared income corresponding to the value of those assets as “unjustified capital gains,” with no possibility, in practice, of benefiting from the rules on limitation periods; and
- The imposition of proportional and specific flat-rate fines.

According to the CJEU, the obligation at issue was likely to:

- Deter Spanish residents from investing in other Member States; or
- Impede or restrict the opportunities for them to do so.

The obligation therefore constituted a restriction on the free movement of capital, within the meaning of Article 63(1) of the TFEU.

The Court conceded that, since the level of information available to the national authorities concerning assets held by their tax residents abroad was, overall, lower than that available to them concerning assets located on their territory, even taking into account the existence of mechanisms for the exchange of information or administrative assistance between the Member States, the legislation at issue appeared appropriate to ensuring the attainment of the objectives pursued, i.e.:

- (i) Guaranteeing the effectiveness of fiscal supervision; and
- (ii) Preventing tax evasion.

However, the mere fact that a resident taxpayer had assets or rights outside the territory of a Member State could not give rise to a general presumption of tax evasion and avoidance.

Moreover, a provision that presumed the existence of fraudulent behavior on the sole ground that the conditions laid down by it were fulfilled, without giving the taxpayer any opportunity to rebut that presumption, went beyond what was necessary to achieve the objective of combating tax evasion and avoidance.

The Court concluded that, by attaching far-reaching consequences to failure to comply with a declaratory obligation, the Spanish legislature had made a choice that went beyond what was necessary to guarantee the effectiveness of fiscal supervision and combat tax evasion and avoidance.

Nor did the Court see any need to consider the conclusions to be drawn from the existence of mechanisms for the exchange of information or administrative assistance between Member States.

e. Cross-Border Philanthropic Activity

The CJEU has dealt with the taxation of public-benefit organizations (PBOs) and their donors in a series of cases.³⁵²

According to the CJEU, Member States have the discretion to decide whether they wish to provide tax privileges to PBOs and their donors. Similarly, Member States are free to determine the relevant conditions and requirements.

It is, theoretically, also permissible for the beneficiary circle, i.e., the recipients of the support of the PBO, to be limited to domestic citizens or persons living within the domestic territory.

In particular, Member States are not obliged to automatically grant a status equivalent to that of a domestic PBO to a foreign EU-based PBO recognized as holding a tax-privileged public-benefit status in its country of origin. However, it is not permitted for foreign EU-based PBOs and their donors to be excluded from eligibility for tax privileges if, their seat aside, they meet all the requirements of the national public-benefit tax law.

Nor is it permitted that a (domestic or foreign EU-based) PBO should be required to undertake its philanthropic activities in the Member State that grants the tax privilege, unless there are compelling objective reasons for this.

Such reasons do not exist, for example, in the case of the promotion of science as a public-benefit purpose. Member States must not restrict tax benefits to donors of gifts made to domestic universities or laboratories.

In cross-border cases, it is necessary for Member States to conduct a comparability test to determine whether a foreign EU-based PBO meets the requirements of national tax law.

Such tests are to be carried out by the national authorities and courts of the Member State concerned. Within the framework of the comparability test, the competent national authorities may require a foreign PBO, and/or, as relevant, its donors, to provide any documentation they deem useful for conducting the comparability test.

³⁵⁰ Case C-647/20, *XG v. Autoridade Tributaria e Aduaneira*.

³⁵¹ Case C-788/19, *Commission v. Spain*.

³⁵² Case C-386/04, *Centro di Musicologia Walter Stauffer*; Case C-318/07, *Persche*; Case C-25/10, *Missionswerk Werner Heukelbach*; Case C-10/10, *Commission v. Austria*.

f. Convertible Interest-Free Loans

*Viva Telecom Bulgaria*³⁵³ concerned a claim of the Bulgarian tax authorities, based on a domestic anti-abuse provision, that fictitious or deemed interest — on which a 10% withholding would be due — should be imputed in the context of a convertible interest-free loan granted by a Luxembourg-based parent company to its Bulgarian subsidiary.

After rejecting the application of:

- The Parent-Subsidiary Directive;
- The Interest and Royalty Directive; and
- The Capital Duty Directive (see IV., V. and XIV., below, respectively),

the CJEU concluded that Article 63 of the TFEU, read in the light of the principle of proportionality, had to be interpreted as not precluding national legislation that provided for the taxation in the form of a withholding tax of notional interest that a resident subsidiary that had been granted an interest-free loan by its non-resident parent company would have had to pay had the loan been concluded under market conditions.

Such legislation was not precluded where the withholding tax applied to the gross amount of the interest, without it being possible to deduct, at that stage, expenses related to the loan since a subsequent application to that effect was necessary for the purposes of recalculating the tax and possibly making a refund, to the extent:

- The length of the procedure laid down for that purpose by the legislation was not excessive; and
- Interest was payable on the amounts refunded.

g. Stamp Duties

*Faurécia v. Portugal*³⁵⁴ concerned Portuguese legislation under which short-term cash transactions were exempt from stamp duty if they involved two entities established in that Member State, but were not exempt if the borrower was established in another Member State.

The CJEU concluded that the Portuguese tax rules at issue, by exempting only domestic borrowers from stamp duty, create a difference in treatment based on the borrower's place of residence. This difference diminishes the attractiveness of foreign investments for Portuguese residents and restricts nonresident borrowers from raising capital in Portugal. Consequently, the Court held the legislation at issue to be incompatible with Article 63 of the TFEU.

h. Impact of Legal Personality

Whether an entity has or does not have legal personality is in itself irrelevant to the assessment of whether there is differential treatment of third-country entities under the free movement of capital principle. This is illustrated in *Finanzamt für Großbetriebe v. Franklin Mutual Series Funds — Franklin Mutual European Fund*,³⁵⁵ a case that concerned a US-based sub-

fund that was denied a withholding tax refund by the Austrian tax authorities. The denial was based on the Austrian tax authorities' argument that the nonresident sub-fund was comparable to an Austrian-resident investment fund. The CJEU upheld this reasoning, ruling that a nonresident entity that has separate legal personality and the same characteristics as a resident investment fund is not necessarily in a different situation from that of a resident investment fund without legal personality if the dividends received by the nonresident entity are attributed to its unitholders and taxed not at the entity level but at the level of the entity's unitholders in the entity's State of residence. In other words, a nonresident entity may be treated as comparable to a resident UCITS fund if it satisfies equivalent substantive criteria, such as risk-spreading and taxation at the unitholder level.

F. The TFEU Fundamental Freedoms and Bilateral Tax Treaties

1. Primacy of EU Law — Compatibility Issues

Although Article 293 of the former EC Treaty³⁵⁶ has not been reproduced in the TFEU, it is commonly accepted that Member States (continue to) have authority to conclude tax treaties.³⁵⁷

In the absence of any unifying or harmonizing Community measures, Member States retain the power to define, by treaty or unilaterally, the criteria for allocating their powers of taxation, particularly with a view to eliminating double taxation.³⁵⁸

In that context, it is for the Member States to take the measures necessary to prevent double taxation by applying, in particular, the apportionment criteria followed in international tax practice, including the model conventions drawn up by the OECD.³⁵⁹

³⁵⁶ Former EC Treaty, Art. 293 (repealed by the Treaty of Lisbon) required Member States to enter into negotiations with each other with a view to the abolition of double taxation within the Community. While Art. 293 is not reproduced in the TEU/TFEU, the general provisions of TEU, Art. 4 (3) prescribe that the Member States are to facilitate the achievement of the Union's tasks and refrain from any measure that could jeopardize the attainment of the Union's objectives.

³⁵⁷ Case C-307/97, *Saint-Gobain*: "Member States are at liberty, in the framework of [(bilateral) tax treaties], to determine the connecting factors for the purposes of allocating powers of taxation." See also the explicit references to bilateral tax treaties in the Merger Tax Directive and the Parent-Subsidiary Directive.

³⁵⁸ Case C-307/97, *Saint-Gobain*. Such allocation may result in tax disparities disadvantageous to EU citizens exercising their freedoms under the Treaty, but these disparities are not necessarily discrimination within the meaning of EU law. See e.g., Case C-194/15, *Baudinet and Others* (Order of the Court), where the CJEU held that TFEU, Arts. 49, 63 and 65 do not preclude legislation of a Member State under which, when a resident of that Member State that is a shareholder in a company established in another Member State receives from that company dividends taxed in both States, that double taxation is not remedied by the grant in the shareholder's State of residence of a tax credit at least equal to the amount of tax paid in the State of source of those dividends; indeed, the residence Member State is not required, under EU law as it currently stands, to compensate a tax disadvantage resulting from the simultaneous exercise of tax jurisdiction by both Member States.

³⁵⁹ Case C-524/04, *Test Claimants in the Thin Cap Group Litigation*, referring to Case C-336/96 *Gilly*; Case C-470/04 *N*; and Case C-513/04 *Kerckhaert and Morres*.

³⁵³ Case C-257/20, *Viva Telecom Bulgaria*.

³⁵⁴ Case C-420/23, *Faurécia v. Portugal*.

³⁵⁵ Case C-602/23, *Finanzamt für Großbetriebe v. Franklin Mutual Series Funds — Franklin Mutual European Fund*.

However, as is the case with their domestic tax legislation,³⁶⁰ tax treaties entered into by and among the Member States should not be in violation of their obligations resulting from the TFEU and, more specifically, the fundamental freedoms laid down therein.³⁶¹

In *Avoir Fiscal*,³⁶² the CJEU stated clearly for the first time that “the rights conferred by Article [49 of the TFEU] are unconditional and a Member State cannot make respect for them subject to the contents of an agreement concluded with another Member State.”

The Court further added that “that Article does not permit those rights to be made subject to a condition of reciprocity imposed for the purpose of obtaining corresponding advantages in other Member States.”

In other words, according to the CJEU, EU law had primacy over the Member States’ bilateral tax treaties.³⁶³

The Court held that such primacy applied with respect to tax treaties concluded by and among Member States, both before and after:

- (i) The entry into force of the founding Treaties (for “old” Member States); or
- (ii) They became Member States (for “acceding” Member States).³⁶⁴

Tax treaty rules in conflict with EU law could not be applied. The loyalty principle (Article 4 of the TEU) required Member States to:

- (i) Renegotiate bilateral (and multilateral) treaties concluded between them in conflict with EU law; or
- (ii) Apply such treaties in accordance with EU law.³⁶⁵

As regards (bilateral) tax treaties concluded between Member States and third countries, the position is somewhat different.

The first paragraph of Article 351 of the TFEU provides that the rights and obligations arising from agreements concluded before:

- (i) January 1, 1958 (the date of entry into force of the (founding) Treaty of Rome); or
- (ii) The date of their accession (for acceding Member States),

³⁶⁰ See the CJEU’s constantly-repeated mantra “although as Community law stands at present direct taxation does not as such fall within the purview of the Community, the powers retained by the Member States must nonetheless be exercised consistently with Community law”.

³⁶¹ Case C-307/79, *Saint-Gobain*. However, where, in allocating taxing powers among themselves, Member States choose different connecting factors, this cannot in itself constitute discrimination prohibited by EU law (Case C-336/96, *Gilly*).

³⁶² Case 270/83, *Avoir fiscal*.

³⁶³ See Case 270/83, *Avoir Fiscal*; see also Case 265/04, *Bouanich*.

³⁶⁴ Case C-286/86, *Deserbais*.

³⁶⁵ TEU, Art. 4(3), second para. provides that Member States must take all appropriate measures, general or particular, to ensure fulfillment of the obligations arising out of the Treaty or resulting from the acts of the institutions of the Union. If, therefore, the application of a provision of EU law is liable to be impeded by a measure adopted pursuant to the implementation of a bilateral agreement, even where that agreement falls outside the field of application of the Treaty, every Member State is under a duty to facilitate the application of that provision and, to that end, to assist every other Member State that is under an obligation under EU law (see, e.g., Case 235/87, *Matteucci*).

between one or more Member States and one or more third countries, are not affected by the provisions of the TFEU (or the TEU).

Thus, such agreements — including (but not limited to) tax treaties — maintain their validity to the extent necessary to preserve the rights of the third country contractor, but not the rights of the Member States.³⁶⁶

A Member State cannot, therefore, invoke a right that it derives from a treaty with a third country if the exercise of that right would contravene its EU law obligations.³⁶⁷

Notwithstanding the above, the second paragraph of Article 351 of the TFEU requires Member States to take all appropriate steps to eliminate the incompatibilities established with the TFEU.³⁶⁸

As regards “posterior” treaties, the primacy of EU law should be admitted based on an *a contrario* interpretation of the first paragraph of Article 351 of the TFEU (and the loyalty principle enshrined in Article 4(3) of the TEU).

Even if it is the third country that proposes the inclusion of a provision in a tax treaty that contains a material breach of EU law (for example, a provision that discriminates against the citizens of other Member States, as do certain anti-abuse clauses (e.g., (certain) limitation on benefits clauses — see II.F.3., below), the Member State that is a party to the tax treaty would be guilty of a violation of the Treaty if it agreed to enter into such a contractual relation.

³⁶⁶ See, e.g., Case C-286/86, *Deserbais*, where the CJEU held that “the purpose of [TFEU, Art. 351.] first para. is to lay down, in accordance with the principles of international law, that the application of the [TFEU] does not affect the duty of the Member State concerned to respect the rights of nonmember countries under a prior agreement and to perform its obligations under that agreement; however, provided the rights of nonmember countries are not involved, a Member State cannot rely on the provisions of a pre-existing convention of that kind to justify restrictions on the marketing of products coming from another Member State where the marketing of such goods is lawful by virtue of the free movement of goods provided for by the Treaty.”

³⁶⁷ Compare Case C-812/79, *Juan Burgoa*, where the CJEU stated that: “Article [351] is of general scope and applies to any international agreement, irrespective of subject matter, which is capable of affecting the application of the Treaty. Although the first paragraph of Article [351] makes mention only of the obligations of the Member States, it would not achieve its purpose if it did not imply a duty on the part of the institutions of the Community not to impede the performance of the obligations of Member States which stem from a prior agreement. However, that duty of the Community institutions is directed only to permitting the Member State concerned to perform its obligations under the prior agreement and does not bind the Community as regards the non-member country in question. Since the purpose of the first paragraph of Article [351] is to remove any obstacle to the performance of agreements previously concluded with non-member countries which the accession of a Member State to the Community may present, it cannot have the effect of altering the nature of the rights which may flow from such agreements. From that it follows that that provision does not have the effect of conferring upon individuals who rely upon an agreement concluded prior to the entry into force of the Treaty or, as the case may be, the accession of the Member State concerned, rights which the national courts of the Member States must uphold. Nor does it adversely affect the rights which individuals may derive from such an agreement.”

³⁶⁸ For example, through mutual assistance between Member States, diplomatic pressure or adopting a common attitude to a third country that refuses to amend the tax treaty. In the nontax area, the CJEU has repeatedly held that the obligation the Member States have to eliminate any incompatibility ultimately requires the denunciation of the pre-accession treaty, if re-negotiation or adjustment of the pre-accession treaty fails or is impossible (see, e.g., Case C-205/06, *Commission v. Austria*; Case C-249/06, *Commission v. Sweden*).

The confirmation of an existing restriction in a new tax treaty (posterior to the TFEU) leads to the restriction being regarded as a posterior restriction.

2. Most Favored Nation Treatment

The EU founding treaties do not include an express most favored nation (MFN) clause that would require Member States to make the benefits of a bilateral tax treaty available to residents of the Member States that are not parties to the treaty.

The CJEU derives from this that a bilateral tax treaty inherently applies to the residents of the two Member States concerned so that residents of a third Member State are not in the same or a comparable situation.

For example, in *D*,³⁶⁹ the CJEU held that the free movement of capital did not preclude a rule laid down by a bilateral tax treaty from not being extended to residents of a Member State that was not a party to that treaty.

In other words, as regards the bilateral tax treaties concluded by the Member States, according to the CJEU, the scope of such treaties was limited to the natural or legal persons referred to in them.³⁷⁰

As such, where a benefit granted by a bilateral tax treaty could not be classified as a benefit separable from that treaty, but contributed to its overall balance (the fact that the reciprocal rights and obligations arising under that treaty applied only to persons resident in one of the two contracting Member States being an inherent consequence of the nature of bilateral tax treaties), EU law did not preclude the benefit in question from not being conferred on a resident of a third Member State, insofar as that resident was not in a situation comparable to that of residents covered by the tax treaty in question.³⁷¹

In the Court's view, advantages granted to the nationals of a Member State by a tax treaty concluded by that State with another Member State or a third country did not have to be extended to all EU nationals, but only to those among them that, by having exercised a fundamental freedom or right, were in a situation comparable to that of the nationals of the first State.

The CJEU's ruling in *Riskin and Timmermans*³⁷² constituted yet another confirmation of that view.

Comment (1): Certain authors have criticized the CJEU's position on the grounds that the TFEU prohibits not only vertical discrimination (i.e., different treatment of a domestic and a cross-border situation), but also horizontal discrimination (i.e., different treatment of two cross-border situations).³⁷³

³⁶⁹ Case C-376/03, *D*, paras. 61–63).

³⁷⁰ See Case C-376/03, *D*., and Case C-374/04, *Test Claimants in Class IV of the ACT Group Litigation*.

³⁷¹ Case C-194/06, *Orange European Smallcap Fund*.

³⁷² Case C-176/15, *Riskin and Timmermans*.

³⁷³ In her opinion in Case C-512/13, *Sopora*, Advocate-General Kokott stresses that the CJEU has, with regard to the question of whether the fundamental freedoms also prohibit differentiation between nationals of different Member States, up to now given varying signals: on the one hand, it rejected the view that unequal treatment depending on the Member State of establishment alone constitutes an impairment of the freedom of establishment under TFEU, Art. 49 (Case C-298/05, *Columbus Container Services*) and, with regard to the free movement of capital under TFEU, Art. 63(1), which also includes third countries, the Court did not view the differing treatment of capital gains, depending on the third country in which they originate, as falling under the protection of that provision (Joined Cases C-436/08 and C-437/08, *Haribo*); on the other hand, also in the context of the free movement of capital, the Court

Comment (2): It is worth noting that the CJEU's reasoning is somewhat strange, as it seems to have applied the MFN principle and tacitly admitted it into the indirect tax area.³⁷⁴

3. "Limitation on Benefits" Clauses

Bilateral tax treaties generally include clauses that refuse residents of a contracting State the right to claim treaty benefits with respect to income derived from the other contracting State if they are not the "beneficial owners" of the income.

Limitation on Benefits (LOB) clauses in tax treaties, particularly where the United States is a contracting State, provide objective criteria for limiting taxpayers' rights under the treaties with a view to preventing treaty abuse and treaty shopping structures (for example, the use of conduit companies or stepping-stone operations).

LOB clauses, however, prove to be problematic from the perspective of the TFEU freedoms, in particular, the freedom of establishment and the free movement of capital principle.

The Court has dealt with the LOB clauses in a number of cases, starting with the (nontax) *Open Skies* cases,³⁷⁵ which concerned "open skies"-type bilateral agreements entered into by the United States with a number of Member States to facilitate, in particular:

- (i) Free access to all routes;
- (ii) The granting of unlimited route and traffic rights;
- (iii) The fixing of prices in accordance with a system of "mutual disapproval;" and
- (iv) The possibility of sharing codes.

The Commission had brought actions against seven Member States (Austria, Belgium, Denmark, Finland, Germany, Luxembourg and Sweden), all signatories to "open skies" agreements, as well as an action against the United Kingdom. The Commission alleged, among other issues, that by concluding the agreements these Member States had infringed the provisions of the Treaty concerning the right of establishment by permitting the United States to refuse traffic rights in its airspace to air carriers designated by the Member State that was party to the agreement concerned, if a substantial part of the ownership and effective control of that carrier were not vested in that Member State or in its nationals (clause on the ownership and control of airlines).

The CJEU found this clause to amount to a case of discrimination excluding air carriers of other Member States from the benefit of national treatment in the host Member State, which was forbidden by the EU rules on the right of establishment.

found an impairment of the fundamental freedom by reason of the unequal treatment of various other Member States by the State of origin (Case C-194/06, *Orange European Smallcap Fund*). In other decisions, both in the context of the free movement of capital and in that of the freedom of establishment, the Court has at least examined whether the differing treatment of various non-residents constitutes an impairment of the fundamental freedom in the specific case in question (see Case C-376/03, *D* and Case C-374/04, *Test Claimants in Class IV of the ACT Group Litigation*). Thus, the position remains unclear.

³⁷⁴ See, e.g., Joined Cases C-367/93-377/93, *Rodgers*; Case C-235/87, *Mateucci*; Case C-32/80, *Kortmann*; Case C-55/00, *Gottardo*.

³⁷⁵ Joined Cases C-466/98, C-469/98, C-471/98, C-472/98, C-475/98 and C-476/98, *Open Skies*.

The Court added that such a clause could not be justified on the grounds of public order and public safety as there was no direct link between any threat and the generalized discrimination against EU airlines.

Accordingly, the clause on the ownership and control of airlines was held to be contrary to the rules on the right of establishment.

Transposed into the context of bilateral tax treaties, the CJEU's ruling implies that an express limitation on the benefits conferred by a tax treaty on a resident company based on the nationality of its shareholders is necessarily discriminatory given that a Member State's nationals are always comparable on the grounds of nationality.

In other words, one could infer from the *Open Skies* judgments that EU law, in particular the freedom of establishment (or the free movement of capital principle) would prohibit Member State A from concluding a tax treaty with State B if the effect was that a company resident in State B was worse off if it had shareholders who were nationals of Member State C instead of either Member State A (vertical discrimination, i.e., different treatment between a domestic and a cross-border situation) or another Member State (horizontal discrimination, i.e., different treatment between two cross-border situations).

One might even take the view that, in these scenarios, it was not only the freedom of establishment (or the free movement of capital principle) that was infringed by a Member State's exercise of its taxing powers, but also the loyalty principle enshrined in Article 4(3) of the TEU through the act of allocation of tax sovereignty (obligation of cooperation in good faith), as it was against EU law for a Member State to adopt rules likely to contravene EU law provisions.

By contrast, when the LOB clause takes the form of a residence requirement, the CJEU has upheld the relevant national provision given that nonresidents are not, as such, comparable to residents (without prejudicing their entitlement to become residents by exercising their EU fundamental freedoms and rights).

For example, *Test Claimants in Class IV of the ACT Group Litigation*,³⁷⁶ concerned the LOB provision contained in the 1980 United Kingdom-Netherlands tax treaty, which did not provide for an entitlement to a tax credit with respect to dividends if the nonresident shareholder concerned was itself owned by a company established in a Member State or a third country with which the United Kingdom had concluded a tax treaty that did not provide for the entitlement to a tax credit to companies receiving dividends from U.K. resident companies (or companies resident in a country with which the United Kingdom had not concluded a tax treaty).

The CJEU held that, even where such LOB provisions extended to the situation of a company that was not resident in one of the contracting Member States, they applied only to persons resident in one of those Member States and, by contributing to the overall balance of the tax treaties in question, were an integral part of them.

The fact that those reciprocal rights and obligations applied only to persons resident in one of the two contracting

Member States was an inherent consequence of bilateral double taxation agreements.

Thus, as regards the taxation of dividends paid by a company resident in the United Kingdom, a company resident in a Member State that had concluded a tax treaty with the United Kingdom that did not provide for such a tax credit was not in the same situation as a company resident in a Member State that had concluded a tax treaty that did provide for one. Therefore, the Treaty provisions on the freedom of establishment did not preclude a situation in which the entitlement to a tax credit laid down in a tax treaty concluded by a Member State with another Member State for companies resident in the second State that received dividends from a company resident in the first State did not extend to companies resident in a third Member State with which the first State had concluded a tax treaty that did not provide for such an entitlement.

Since such a situation did not discriminate against nonresident companies receiving dividends from a resident company, the same conclusion also applied to the Treaty provisions relating to the free movement of capital.

It therefore appears that, in the CJEU's view, LOB provisions denying tax treaty benefits with regard to nationality are in breach of EU law (*Open Skies*), while LOB provisions with regard to residence may be EU law compliant (*Test Claimants in Class IV of the ACT Group Litigation*).³⁷⁷

4. Elimination or Mitigation of Juridical Double Taxation

Under Article 293, second indent of the EC Treaty (the predecessor of the TFEU), Member States were urged "so far as is necessary, [to] enter into negotiations with each other with a view to securing for the benefit of their nationals (...) the abolition of double taxation within the Community."

While this provision could be held to constitute a genuine impetus to eliminate double taxation, at least in an EU context, the CJEU held in *Gilly*³⁷⁸ that Article 293 "is not intended to lay down a legal rule directly applicable as such, but merely defines a number of matters on which the Member States are to enter into negotiations with each other 'so far as is necessary.' Its second indent merely indicates the abolition of double taxation within the Community as an objective of any such negotiations. Although the abolition of double taxation within the Community is thus included among the objectives of [the EC] Treaty, it is clear from the wording of that provision that it cannot itself confer on individuals any rights on which they might be able to rely before their national courts."

In other words, lacking direct effect, Article 293 could not be relied upon by individual taxpayers to challenge any double taxation that they were facing.

³⁷⁶ Case C-374/04, *Test Claimants in Class IV of the ACT Group Litigation*.

³⁷⁷ See, however, (nontax) Case C-299/02, *Commission v. Netherlands (Dutch Ship Registration)*, concerning national measures requiring, as a condition for being able to register a ship in The Netherlands, that the shareholders, directors and natural persons responsible for the day-to-day management of the EU company owning the ship should have EU or European Economic Area (EEA) nationality and that the director of a shipping company should be of EU or EEA nationality or have EU or EEA residence, where the CJEU rejected restrictions with regard to both EU/EEA nationality and EU/EEA residence.

³⁷⁸ Case C-336/96, *Gilly* (referring to Case 137/84, *Mutsch*).

Upon the repeal of Article 293 of the EC Treaty by the Lisbon Treaty,³⁷⁹ the question arose as to whether the general provisions of Article 4(3) of the TEU (former Article 10 of the EC Treaty) could be of any assistance in the context of the elimination or mitigation of juridical double taxation.³⁸⁰

Comment: In the author's opinion, it is doubtful whether Article 4(3) may constitute, in and by itself, a sufficient basis for imposing an obligation on the Member States to eliminate or mitigate double taxation in an EU cross-border context. The reason for this skepticism is, first and foremost, that in the CJEU's view, the obligations contained in Article 4(3) are insufficiently precise and thus cannot produce a direct effect in relations between the Member States and their subjects, i.e., Article 4(3) is not a self-sufficient legal provision from which subjective legal rights may be derived.³⁸¹

Rather, Article 4(3) is intended to come into play, not independently, but only on an entirely residual basis because any measure found to be incompatible with Article 4(3) will fall within the scope of some other, more specific, prescriptive provision of the TFEU (for example, the fundamental freedoms — see below). In such cases, it will be the specific provision that must be applied and not the prohibition laid down by the second paragraph of Article 4(3).³⁸²

The “residual” character of Article 4(3) is further illustrated in the decision of the CJEU in *Caterpillar Financial Services*³⁸³ in the value added tax (VAT) area.

It is therefore reasonable to contend that the principle of sincere cooperation, as interpreted by the CJEU to date, does not offer a basis for imposing an obligation on Member States to eliminate or mitigate double taxation in an EU cross-border context.

³⁷⁹Treaty of Lisbon amending the Treaty on European Union and the Treaty Establishing the European Community, Lisbon, Dec. 13, 2007 (2007/C 306/01) (Official Journal of Dec. 17, 2007, C 306).

³⁸⁰Article 4(3) provides as follows: “Pursuant to the principle of sincere cooperation, the Union and the Member States shall, in full mutual respect, assist each other in carrying out tasks which flow from the Treaties [i.e., the TEU and the TFEU]. The Member States shall take any appropriate measure, general or particular, to ensure fulfilment of the obligations arising out of the Treaties or resulting from the acts of the institutions of the Union. The Member States shall facilitate the achievement of the Union's tasks and refrain from any measure which could jeopardize the attainment of the Union's objectives.”

³⁸¹See Case 9/73, *Schlütter*, Joined Cases C-79/90 to C-83/90, *Compagnie Commerciale de l'Ouest and Others*.

³⁸²Opinion of Advocate General TESAURIO in Joined Cases C-79/90 to C-83/90, *Compagnie Commerciale de l'Ouest and Others*; compare with the CJEU's reasoning in Joined Cases C-79/90 to C-83/90, *Compagnie Commerciale de l'Ouest*, following which “[t]he wording of [Article 4(3)] is so general that there can be no question of applying [it] independently when the situation concerned is governed by a specific provision of the [TFEU].”

³⁸³Case C-500/16, *Caterpillar Financial Services*. The CJEU held that, in the absence of harmonized rules governing the reimbursement of charges imposed in breach of EU law, the principles of effectiveness and equivalence, read in the light of TEU, Art. 4(3), must be interpreted as not precluding national legislation that allows a request for a refund of an overpayment of VAT to be refused where that request was submitted by the taxable person after the expiry of the five-year limitation period, although it follows from a judgment of the Court, delivered after the expiry of that period, that the payment of the VAT that was the subject of that request for a refund was not payable. As regards the principle of sincere cooperation, the CJEU specifically noted that, where a limitation rule provided for in a national tax code is consistent with the principles of equivalence and effectiveness, it cannot be considered to infringe the principle of sincere cooperation — in those circumstances, it cannot be claimed that the EU Member State concerned, by applying that limitation rule, undermines the achievement of the Union's aims.

In the author's opinion, implicit confirmation of this proposition may be found in *Levy and Sebbag*,³⁸⁴ in which the CJEU considered the free movement of capital principle in conjunction with Article 4(3) of the TEU and concluded that Article 4(3) could not be interpreted in such a way as to impose obligations on Member States that went beyond the obligations arising from the free movement of capital principle laid down in Article 63 of the TFEU.

To the extent that, in the author's opinion, Article 4(3) of the TEU offers an insufficient basis for imposing a genuine obligation on Member States to eliminate or mitigate double taxation in an EU cross-border context, the question arises as to whether unrelieved double taxation, like any other tax impediment, may constitute a violation of the fundamental freedoms enshrined in the TFEU. This question is nearly as old as the TFEU itself (as it developed from its predecessors).

It is true that the CJEU has developed an extensive (and ever-increasing) body of case law according to which the powers retained by the Member States must nonetheless be exercised consistently with EU law (although, as EU law currently stands, direct taxation does not, as such, fall within the purview of the EU).

In other words, national direct tax provisions, including international tax conventions of the Member States must not compromise the freedoms enshrined in the TFEU.

In the CJEU's case law, a national tax rule is found to be in breach of the fundamental freedoms if it:

- (i) Differentiates based on nationality (direct or overt discrimination); or
- (ii) Applies other differentiating criteria (e.g., residence)

but, in fact, leads to the same result as a directly discriminatory rule (indirect or covert discrimination).

At the same time, equally applicable restrictive measures also may be found to violate the Treaty freedoms where they hinder intra-EU trade and render the exercise of the freedoms less attractive.

That being said, double taxation is different from discriminatory taxation, at least in the following two ways.

- (i) First, double taxation is created by the concurrent application of the laws of two taxing jurisdictions, rather than just one.
- (ii) Second, double taxation is not a problem that can be fully cured by the harmonization of domestic tax laws. Unlike discriminatory taxation arising from tax disparities in the Member States' tax legislation, double taxation would persist even if all Member States had exactly the same tax laws because double taxation arises from the simultaneous assertion of source taxing rights by the source country and residence taxing rights by the residence country. Even if every country had the same source and residence rules, those rules would still overlap, resulting in double taxation.³⁸⁵

³⁸⁴Case C-540/11, *Levy and Sebbag* (Order of the Court); see also, below.

³⁸⁵G.W. Kofler and R. Mason, Double Taxation: A European “Switch in Time?”, *Columbia Journal of European Law* [Vol. 14, 2007] at p. 67–68; see also the opinion of Advocate General Geelhoed in Case C-374/04, *Test Claimants in Class IV of the ACT Group Litigation*, where it is emphasized

On the other hand, abstracting from these differences, double taxation imposes a burden on cross-border transactions that wholly domestic transactions do not face, putting taxpayers that exercise their fundamental freedoms under the TFEU at a disadvantage. Taking that approach, it could be argued that the fundamental freedoms encompass an obligation for the Member States to abolish or mitigate double taxation.

While fully acknowledging that:

(i) The risk of unrelieved double taxation of cross-border economic activities in the Community poses a hindrance to competition and hampers the effectiveness of the Internal Market; and

(ii) The abolition of double taxation is definitely a Union goal,

the CJEU has so far proven unwilling to hold that juridical double taxation violates EU law and, in particular, the fundamental freedoms.

Quite the contrary, in a series of cases, the CJEU has held that, under EU law as it then stood, EU Member States were not obliged to adapt their own tax systems to the different tax systems of other Member States. Member States were therefore not obliged to eliminate double taxation if such taxation arose exclusively from the exercise in parallel by those States of their remaining fiscal sovereignty.

The CJEU first expressed this position in *Kerckhaert-Morres*.³⁸⁶ In that case, the CJEU found that Belgian income tax legislation that, in the context of tax on income, made dividends on shares in companies established in Belgium and dividends on shares in companies established in another Member State subject to the same uniform rate of taxation, without providing for the possibility of setting off the tax levied by deduction at source in that other Member State, did not restrict the free movement of capital.

The Court's reasoning was that the adverse consequences that might arise from the application of an income tax system, such as the Belgian tax system at issue, resulted from the exercise in parallel by two Member States of their fiscal sovereignty.

According to the CJEU, EU law, as it then stood, in a situation such as that at issue, did not lay down any general criteria for the attribution of areas of competence between the Member States in relation to the elimination of double taxation within the EU.

The CJEU reiterated its position in *Damseaux*,³⁸⁷ where the Court concluded that the free movement of capital did not preclude a bilateral tax convention from providing that dividends distributed by a company established in one Member State to a shareholder residing in another Member State were liable to be taxed in both Member States, and that did not mean that the

that the fact that direct tax systems are national has as a restrictive consequence that it is necessary to divide taxing jurisdiction over the income of cross-border economic operators (dislocation of tax base). As with disparities, these restrictions should be distinguished from discrimination, as they result not from the rules of one tax jurisdiction alone, but from the co-existence of two separate tax jurisdictions (i.e., no one tax jurisdiction is to blame for the tax disadvantage). However, unlike disparities, they would continue to exist even if national tax systems were exactly the same in design and content.

³⁸⁶ Case C-513/04, *Kerckhaert-Morres*.

³⁸⁷ Case C-128/08, *Damseaux*.

Member State in which the shareholder resided was unconditionally obliged to prevent the resulting juridical double taxation.

In *Levy and Sebbag*,³⁸⁸ the CJEU held that, insofar as EU law, as it then stood, did not lay down any general criteria for the attribution of areas of competence between the Member States in relation to the elimination of double taxation within the EU, the free movement of capital was to be interpreted as meaning that it did not preclude a situation in which a Member State that had undertaken, in a bilateral double taxation agreement, to establish a mechanism to eliminate such double taxation of dividends, subsequently abolished that mechanism by way of a legislative amendment that had the effect of reintroducing double taxation.

In *Baudinet and Others*,³⁸⁹ the CJEU held that Articles 49, 63, and 65 of the TFEU did not preclude legislation of a Member State that did not remedy the double taxation resulting from the simultaneous exercise of taxing jurisdiction by two Member States.

Under the legislation of that Member State, when a resident of that Member State that was a shareholder in a company established in another Member State received from that company dividends taxed in both States, that double taxation was not remedied by the grant in the shareholder's State of residence of a tax credit at least equal to the amount of tax paid in the State of the source of those dividends.

The residence Member State was not required, under EU law as it then stood, to compensate a tax disadvantage resulting from the simultaneous exercise of taxing jurisdiction by both Member States.

The CJEU's position is undoubtedly prompted by the fact that EU law, as it currently stands, does not lay down any general criteria for the attribution of areas of competence between the Member States in relation to the elimination of double taxation, implying that the Member States (continue to) enjoy a certain degree of autonomy in the area of direct taxation as long as they exercise their powers in compliance with EU law.

Perhaps even more significant is the fact that, if the CJEU were to hold that double taxation violates the fundamental freedoms enshrined in the TFEU, it would presumably also have to decide which State — source or residence — is responsible for relieving the double taxation, which potentially raises compatibility issues with the fiscal sovereignty of Member States and, thus, also with the principle of subsidiarity, especially in a non-harmonized area such as that of direct taxation.

In short, under CJEU case law as it currently stands, a national tax provision creating juridical double taxation may only be open to challenge under the fundamental freedoms if it has a discrimination feature (whether overt or covert) attached to it.

By contrast, in the Court's opinion, juridical double taxation as such is not contrary to the fundamental freedoms, i.e., where it arises exclusively from the exercise in parallel by Member States of their remaining fiscal sovereignty.³⁹⁰

³⁸⁸ Case C-540/11, *Levy and Sebbag* (Order of the Court).

³⁸⁹ Case C-194/15, *Baudinet and Others* (Order of the Court).

³⁹⁰ Unsurprisingly, this case law attracted (and continues to attract) severe criticism. The main point of criticism relates to the fact that the CJEU's holdings in *Kerckhaert-Morres*, *Damseaux* and *Baudinet and Others* are, arguably, a departure from the "double (or dual) burden" approach that the CJEU seems

Comment: It is also worth noting that, paradoxically, resolving the discrimination issue under the fundamental freedoms may in certain instances be conducive to (juridical or economic) double taxation.

A notable example is the CJEU's finding that the *avoir fiscal* that used to be available under French tax law was discriminatory unless it was also granted with respect to dividends on shares in foreign companies.³⁹¹

This decision eventually resulted in the cancellation of the tax credit altogether, thus indirectly increasing double taxation.

See also XII.C., below (Double Taxation Dispute Resolution Mechanisms Directive).

G. Fundamental Freedoms and Harmonizing Secondary Tax Legislation

1. Compatibility of Harmonizing Secondary Tax Legislation with Fundamental Freedoms

a. General

The TFEU provides for three mechanisms of judicial review of the legality of EU acts, namely the action for annulment (Article 263 of the TFEU), the preliminary ruling on interpretation and validity (Article 267 of the TFEU) and the plea of illegality (Article 277 of the TFEU).

(1) Action for Annulment

Article 263 (1) of the TFEU empowers the CJEU to review the legality of legislative acts, of acts of the Council, of the Commission and of the European Central Bank, other than recommendations and opinions, and of acts of the European Parliament and of the European Council intended to produce legal effects *vis-à-vis* third parties (the so-called “direct action”). Grounds for annulment are fourfold, i.e., lack of competence, infringement of an essential procedural requirement, infringement of the EU Treaties or of any rule of law relating to their application, or misuse of powers (Article 263(2) of the TFEU).³⁹²

to have adopted in areas other than direct taxation. Under that approach, it is recognized that the dual burden (and thus the disadvantage) placed on cross-border activities by the concurrent (and uncoordinated) application of two or more Member States' national legal systems may violate the fundamental freedoms, particularly if such dual burden hampers EU nationals' access to markets in other EU Member States. The CJEU first applied this approach in Case 120/78, *Rewe-Zentral* (“*Cassis de Dijon*”) in the context of regulatory restrictions on the free movement of goods, and subsequently in the areas of VAT (e.g., Case 15/81, *Schul I*) and social security (e.g., Joined Cases 62/81 and 63/81, *Seco*).

³⁹¹ Case 270/83, *Avoir Fiscal*. Under the *avoir fiscal* rules, a dividend distributed by a French company to its French resident shareholders carried a tax credit (the *avoir fiscal*) equal to 50% of the net dividend (or 33.33% of gross) as part of the French imputation system. The *avoir fiscal* was designed to give some relief from the double taxation resulting from the income tax being imposed both on the company distributing the dividends and on the recipient of the dividends. At issue in *Avoir Fiscal* was France's refusal to extend the *avoir fiscal* benefit to PEs of foreign companies, in casu, branches and agencies in France of insurance companies whose registered offices were in another EU Member State, with respect to dividends paid to them by French companies on the same terms as applied to insurance companies whose registered offices were in France. See 4.a., above.

³⁹² The first two grounds concern the external legality of the challenged act and the last two grounds deal with the internal legality thereof.

Eligible applicants under Article 263 are (i) the EU Member States, the European Parliament, the EU Council or the EU Commission (the so-called “privileged” applicants) who are always allowed to bring actions for annulment; (ii) the Court of Auditors, the European Central Bank and the Committee of Regions (the so-called “semi-privileged” applicants) who have standing only to protect their own institutional prerogatives; and (iii) natural and legal persons (the so-called “non-privileged” applicants) who, under the conditions laid down in the first and second paragraphs, are only allowed to bring an annulment action if (1) they are addressees of the act; or (2) the act in question is of direct and individual concern to them; or (3) the annulment action is against a regulatory act which is of direct concern to them and does not entail implementing measures.

As regards non-privileged applicants, the “direct concern” condition requires an EU act to directly affect an individual's or entity's legal situation without requiring further intermediate rules, i.e., the legal effects of the act must be produced automatically by the act itself without any measure undertaken by a Member State (or, by analogy, any EU body) to give effect to the relevant EU act.³⁹³ Obviously, “direct concern” is a clear impediment for non-privileged applicants to bring an annulment action under Article 263 of the TFEU. An illustration of this point is Case C-146/24 P, *Fugro v. Council*, where the Dutch company, Fugro N.V., had requested to partially nullify the Pillar Two Directive because income obtained from a shipping activity covered by the Dutch tonnage tax regime — authorized by the Commission as compatible with the EU State aid rules — is not included in the international shipping income exclusion of Article 17 of the Directive. The Court, extensively referring to its holding in Joined Cases C-408/15 P and C-409/15 P, *Ackermann Saatzucht and Others v. Parliament and Council*, found that Fugro was affected only in its objective capacity as a parent entity in the maritime sector, not as an individually concerned party. A potential justification for this impediment is, although arguably not convincing,³⁹⁴ the assumption that the preliminary ruling procedure on the validity of an EU act provides a comparable legal protection to that afforded by a direct challenge against that act. On the other hand, there are examples where the CJEU seems to be willing to adopt more flexibility, e.g., in Case C-348/20, *Nord Stream 2*, where the Court held that a directive (regardless of its implementation into national law) can concern a private applicant directly.

An action for annulment under Article 263 of the TFEU, if successful, results in the CJEU declaring an EU act void, which has *erga omnes* effect.

Importantly, proceedings under Article 263 of the TFEU are time-barred, i.e., the time limit for instituting annulment proceedings is fixed at two months, running — in the case of published measures (such as EU directives) — from the end of the fourteenth day after publication of the measure in the EU *Official Journal*.³⁹⁵

³⁹³ See, e.g., Case C-386/96 P, *Dreyfus v. Commission*; Joined Cases C-622/16 P to C-624/16 P, *Scuola Elementare Maria Montessori v. Commission*; and Case C-486/01 P, *Front national v. Parliament*.

³⁹⁴ See Mastroianni, R. and Pezza, A., *Striking the Right Balance: Limits on the Right to Bring an Action Under Article 263(4) of the Treaty on the Functioning of the European Union*, American University International Law Review, Vol. 30, Issue 4, 2015.

³⁹⁵ Article 50 of the Rules of Procedure of the Court of Justice.

(2) Preliminary Ruling on Interpretation and Validity

Article 267 of the TFEU empowers the CJEU to give preliminary rulings concerning: (a) the interpretation of the EU Treaties; and (b) the validity and interpretation of acts of the institutions, bodies, offices or agencies of the Union.

For these purposes, the CJEU has jurisdiction in actions brought by a Member State, the European Parliament, the Council or the Commission, on the same grounds as those set out in Article 263 of the TFEU. Specifically, Article 267 of the TFEU comes into play when a case before a court or tribunal of an EU Member State requires a decision on the interpretation or validity of an EU legal measure in which case the relevant court or tribunal, prior to delivering its judgment, can³⁹⁶ (or where there is no judicial remedy against that judgment under national law: must)³⁹⁷ seek a preliminary ruling from the CJEU.

In its preliminary ruling, the CJEU establishes authoritatively the interpretation or validity of the relevant legislation.

Preliminary rulings of the CJEU on interpretation as well as on validity are considered to have *erga omnes*, as opposed to merely *inter partes*, effect.

Furthermore, Article 267 of the TFEU allows the legality of EU acts to be monitored beyond expiry of the two-month time limit of Article 263.

(3) Plea of Illegality

Article 277 of the TFEU states that any party may, in proceedings in which an act of general application adopted by an institution, body, office or agency of the Union is at issue, plead the grounds specified in Article 263, second paragraph, in order to invoke before the CJEU the inapplicability of that act.

For this purpose, “any party” refers to individuals and legal persons, as well as Member States and EU Institutions (including the EU Council, the EU Commission, and the European Parliament).³⁹⁸

As regards the concept of “acts of general application”, the Court has held that it encompasses both legislative and regulatory acts.³⁹⁹ An “act of general application” is any act which applies to objectively determined situations and entails legal effects for categories of persons envisaged in a general and abstract manner.⁴⁰⁰ The form of an act is irrelevant — its subject matter and content are decisive.⁴⁰¹

³⁹⁶ According to settled case law of the CJEU, national courts or tribunals cannot be deprived of their competence to decide: (a) the relevance of a preliminary question, including that of validity, for the solution of the dispute and (b) the very object of the questions to refer, which in principle may be different from what the parties suggested or similar to what one party requested but opposite to what the other party requested.

³⁹⁷ See e.g., Case C-99/00, *Lyckeskog*; Case C-210/06, *Cartesio*; and in a taxation matter: Case C-416/17, *Commission v. France*. However, there is no obligation to refer if the CJEU has already dealt with the point of law in question or if the correct application of EU law is obvious (*acte claire*).

³⁹⁸ The capacity of Member States and EU institutions to use Article 277 TFEU has long been doubtful as it was essentially seen by the CJEU as a way to circumvent the Article 263 two-month time limit (see e.g., Case C-135/93, *Spain v. Commission*); in 2008, the CJEU changed its position by ruling that an exclusion of the Member States would be incompatible with the wording of Article 277 TFEU, which allows “any party” to raise the plea (Case C-442/04, *Spain v. Council*). The same holds true, by way of extension, for European Institutions. Thus, the CJEU has prioritized the principle of legality.

³⁹⁹ Case C-583/11 P, *Inuit Tapiriit Kanatami and Others v. Parliament and Council*.

Importantly, the plea of illegality is not an independent right of action, but rather an incidental plea in law intended to avoid the application of unlawful EU acts of general application to the detriment of parties who are not entitled to challenge them.⁴⁰² Specifically, the objection of illegality may only be raised in the context of direct actions lodged before the EU Courts, implying that a plea incidentally under Article 277 of the TFEU is to be attached to a main direct action brought under Article 263 of the TFEU; if it is not, the plea is inadmissible.

Where the CJEU on the basis of Article 277 of the TFEU declares inapplicable an act of general application that it finds to be unlawful, such declaration of inapplicability has the force of *res judicata* only with regard to the parties to the dispute and does not have *erga omnes* effect. Thus, the act of general application, as such, is not removed from the EU legal order and remains, although the institution which adopted it usually withdraws it or modifies it in order to correct the defect that has been declared by the Court.

(4) Manifest Error Test

The CJEU recognizes that, in the exercise of the judicial review powers conferred on it, the EU legislature must be allowed broad discretion in the areas where its action involves political choices, economic choices and social choices, and in which it is called upon to undertake complex assessments and evaluations.⁴⁰³

In the Court’s opinion, therefore, the legality of a measure introduced by the EU legislature can only be affected if the measure is manifestly inappropriate, having regard to the objective which the competent institutions are seeking to achieve.⁴⁰⁴

Thus, the test for judicial review of the EU legislature’s discretion is manifest error.

It should be noted that, in general, the CJEU seems quite reluctant to intervene when harmonization measures are implemented in stages or gradually.⁴⁰⁵

b. The Specific Case of the Pillar Two Directive Before and After the OECD Side-by-Side System

The discussion below is intended to assess the EU law compatibility of the Pillar Two Directive “as such”, i.e., as it existed prior to (and thus abstraction made of) the adoption of the Side-by-Side Package (which is discussed separately in at VII.P., below).

(1) EU Law Compatibility of the Pillar Two Directive “As Such”

The Pillar Two Directive is intended to implement the OECD GloBE Model Rules in the EU.

⁴⁰⁰ See e.g., Case 307/81, *Alusuisse Italia SpA v. Council and Commission*; Case C-447/98 P, *Molkerei Großbraunshain GmbH* (Order of the Court); Joined Cases C-622/16 P to C-624/16 P, *Scuola Elementare Maria Montessori v. Commission*.

⁴⁰¹ Case C-784/18 P, *Mellifera v. Commission* (and the case-law cited).

⁴⁰² Case 33/80, *Albini v. Council and Commission*.

⁴⁰³ See, e.g., Case C-203/12, *Billerud*; Case C-390/15, *RPO*; Case C-620/18, *Hungary v. Parliament and Council*.

⁴⁰⁴ See, e.g., Case C-620/18, *Hungary s. Parliament and Council*; Case C-482/17, *Czech Republic v. Parliament and Council*.

⁴⁰⁵ Case C-247/08, *Gaz de France*.

In summary, the OECD GloBE Model Rules aim to ensure that large multinational groups, i.e. MNE groups whose annual consolidated revenues in at least two of the four preceding fiscal years equal or exceed EUR 750 million, pay an effective tax rate of at least 15% tax across every jurisdiction where they have operations. If the effective tax rate in a particular jurisdiction is less than 15%, the Model Rules (i.e., the IIR and its backstop, the UTPR) will come into effect and the group is required to pay a top-up tax to bring the effective tax rate up to 15%. Primarily, the IIR allocates the top-up tax to the highest entity within the chain of ownership that is resident in a jurisdiction that has implemented the IIR. The IIR applies whether or not the jurisdiction of the low-tax constituent entity has implemented the IIR. In situations where the IIR is unable to bring the effective tax rate to 15%, the UTPR effectively leads to a denial of deductions.

The fact that the scope of application of the OECD GloBE Model Rules is limited to large MNE groups, leaving large purely domestic groups unaffected, raised concerns about whether a mere transposition of those Rules into EU law could potentially raise frictions with the (case law of the CJEU on the) EU fundamental freedoms, especially the freedom of establishment, both in respect of the GloBE Model IIR and the GloBE Model UTPR.⁴⁰⁶

As regards the OECD GloBE Model IIR, it attributes the low-taxed undistributed profit of a constituent entity (CE) to, as a matter of principle, the ultimate parent entity of the group (UPE). Therefore, it basically operates as a CFC-rule, the main difference between a CFC-rule and the IIR being that the latter subjects the UPE only to the top-tax on the so-attributed profit, whereas in case of a CFC-rule, the parent company is taxed on the profit at the statutory tax rate of its Member State. Under the OECD GloBE Model Rules, where a UPE based in a Member State exercises its freedom of establishment by setting up subsidiaries in other Member States that are subject to low taxation there, the UPE comes within the ambit of the IIR. A *verbatim* transposition of the GloBE Model IIR into EU law would therefore have led to a restriction on the freedom of establishment of such a UPE. Specifically, it would have treated a UPE with subsidiaries in the same Member State differently from, and less advantageously than, a parent company with subsidiaries based in other Member States because of the low level of taxation imposed on those subsidiaries in those other Member States.⁴⁰⁷ It is also settled case law that any advantage

resulting from the low taxation to which a subsidiary established in a Member State, other than the one in which the parent company is incorporated, is subject, cannot by itself authorize the Member State of the parent company to offset that advantage by less favorable tax treatment of that company. According to the CJEU “*such compensatory tax arrangements prejudice the very foundations of the single market*”.⁴⁰⁸

As regards the OECD GloBE Model UTPR, a mere copy/paste implementation of that rule into EU law would have resulted in a rule that denies the deduction of a cost item only where payments are made to recipients who are resident in other Member States. Such denial is consistently held to discriminate between payments made to domestic and non-domestic recipients and therefore restricts the freedom of establishment, even if the nonresident recipient enjoys a favorable tax regime.⁴⁰⁹

To overcome these potential frictions, various approaches had been suggested by legal scholars, namely:

- (i) An expansion of the scope of the internationally agreed substance-based carve out and transform it into a targeted “artificial arrangement;”
- (ii) A simple enactment of the GloBE minimum tax as internationally agreed, and closely aligned with the GloBE Model Rules (with the downside of legal uncertainty depending on the degree and the way the CJEU might approach the “manifest error” test — see above); or
- (iii) An extension of the GloBE Model Rules to also apply to large, purely domestic groups, implying that the top-up tax would no longer be merely collected cross-border (but also meaning that there will be no longer any *foreign* undertaxed profits for in-scope MNEs in the EU).

The Pillar Two Directive clearly opted for the third alternative. Recital 6 of the Directive expressly states that “[i]t is necessary to implement the OECD Model Rules agreed by the Member States in a way that remains as close as possible to the global agreement, in order to ensure that the rules implemented by the Member States pursuant to this Directive are qualified within the meaning of the OECD Model Rules. This Directive closely follows the content and structure of the OECD Model Rules. To ensure compatibility with primary Union law, and in particular with the principle of freedom of establishment, the rules of this Directive should apply to entities resident in

⁴⁰⁶ One could also question the compatibility of the Pillar Two Directive with Article 107 of the TFEU on State aid (see XVI., below). The reason is that, under the Pillar Two Directive, the tax will fall on a specific category of taxpayers (the vast majority of which will be MNEs). Consequently, it can be questioned whether the tax will be a means of financing an aid measure benefiting domestic entities that are legally or de facto excluded from the scope of the Directive. It is settled case law that taxes form an integral part of state aid measures, and that they must be hypothecated to the aid measure under the relevant rules, in the sense that the revenue from the tax is allocated for the financing of the aid and has a direct impact on the amount of that aid” (see, e.g. Joined Cases C-393/04 and C-41/05, *Air Liquide*; Case C-75/18, *Vodafone*; Case C-323/18, *Tesco* — see, XVI.B.2., below). To the extent that, under the Pillar Two Directive, the revenue raised will not be specifically allocated to funding a tax advantage in favor of a specific group of taxpayers (and such revenue is thus not hypothecated to an aid measure), there should not be an incompatibility issue with the State aid rules.

⁴⁰⁷ Case C-196/04, *Cadbury Schweppes*, §§ 43 – 44: “it is common ground that the legislation on CFCs involves a difference in the treatment of resident

companies on the basis of the level of taxation imposed on the company in which they have a controlling holding. Where the resident company has incorporated a CFC in a Member State in which it is subject to a lower level of taxation within the meaning of the legislation on CFCs, the profits made by such a controlled company are, pursuant to that legislation, attributed to the resident company, which is taxed on those profits. Where, on the other hand, the controlled company has been incorporated and taxed in the United Kingdom or in a State in which it is not subject to a lower level of taxation within the meaning of that legislation, the latter is not applicable and, under the United Kingdom legislation on corporation tax, the resident company is not, in such circumstances, taxed on the profits of the controlled company.” See, in the same vein, Case C-135/17, *X GmbH*.

⁴⁰⁸ See e.g. Case, C-270/83, *Commission v. France*; Case C-294/97, *Eurowings*; Case C-422/01, *Skandia and Ramstedt*; Case C-118/96, *Safir*; Case C-136/00, *Danner*.

⁴⁰⁹ Case C-270/83, *Commission v. France*; Case C-107/94, *Asscher*; Case C-294/97, *Eurowings*; Case C-422/01, *Skandia and Ramstedt*; Case C-118/96, *Safir*; Case C-136/00, *Danner*; Case C-318/10, *SIAT*; Case C-484/19, *Lexel AB*.

a Member State as well as to non-resident entities of a parent entity located in that Member State. This Directive should also apply to large-scale purely domestic groups. In that way, the legal framework would be designed to avoid any risk of discrimination between cross-border and domestic situations. All entities located in a Member State that is low-taxed, including the parent entity that applies the IIR, should be subject to the top-up tax. Equally, constituent entities of the same parent entity that are located in another Member State that is low-taxed should be subject to the top-up tax”.

To align the Directive with the primary EU law (the fundamental freedoms and the freedom of establishment in particular), the key-substantive differences with the GloBE Model Rules and chosen design options seem to be the following:

- (i) Application of the IIR to large-scale domestic groups, i.e. extension of the application of the GloBE Model IIR to purely domestic groups established in a Member State if they reach the EUR 750 million threshold;⁴¹⁰
- (ii) Domestic top-up tax, i.e., to safeguard the tax sovereignty of EU Member States, the Directive provides that an EU Member State can choose to apply the top-up tax domestically to constituent entities located in its territory, thus allowing the top-up tax to be allocated to and collected in the low-tax jurisdiction, instead of collecting the additional tax at the level of the ultimate parent entity of the group; when an EU Member State chooses to elect this option, the amount of top-up tax due by the ultimate parent entity shall be reduced (up to zero) by the amount of top-up tax due by the constituent entities; and
- (iii) Application of the UTPR when the ultimate parent entity is located outside the EU in a jurisdiction that has not implemented the IIR.

In addition, the Directive provides that the UTPR is also applicable when the ultimate parent entity is located in a jurisdiction outside the EU that has implemented the IIR, but the ultimate parent entity (together with the other constituent entities in that jurisdiction) is low-taxed — based on the UTPR, the top-up tax corresponding to the jurisdiction of the ultimate parent entity is allocated to all entities that have implemented the UTPR, including those located in a Member State; the UTPR, however, is not applicable when the ultimate parent entity is located in a Member State, because an ultimate parent entity located in a Member State, applies the IIR principles.

A successful challenge of the Pillar Two Directive under the CJEU judicial review mechanisms described in II.G.1.a., above, seems remote.

First, a challenge of that Directive (or parts thereof) under Article 263 of the TFEU is no longer legally possible. The Pil-

lar Two Directive having been published in the EU *Official Journal* on December 22, 2022, the Article 263 two-month time limit has expired some time ago.

Nor is, at the current stage, the plea of illegality a viable option to test the EU compatibility of the Pillar Two Directive, namely because its incidental character and thus its inherent “dependency” on (the timely filing of) a main direct action brought under Article 263 of the TFEU.

However, a potential challenge of the Pillar Two Directive (or parts thereof) could technically still be based on the preliminary ruling mechanism of Article 267 of the TFEU which, as indicated, requires the intervention of an EU Member State national court or tribunal and thus an underlying legal action brought before such court or tribunal. Having regard to above-referenced adjustments made by the Pillar Two Directive to the OECD GloBE Model Rules in an attempt to overcome potential frictions with EU law, especially the EU fundamental freedoms and the EU freedom of establishment in particular, the general feeling seems to be that the Pillar Two Directive is likely to survive the “manifest error” scrutiny of the CJEU.

Despite this tentative conclusion, it should be noted that the American Free Enterprise Chamber of Commerce (AFECC), an American 501(c)(6) nonprofit organization, recently filed a ruling request with the Belgian Constitutional Court to annul the Belgian UTPR. According to the AFECC, the Belgian UTPR violates the territoriality principles of the 1831 Belgian Constitution, the European Convention on Human Rights of 1950, and the EU Charter of Fundamental Rights of 2009 by imposing taxes on Belgian companies based on income earned by foreign entities. According to the plaintiff, the Belgian UTPR:

- (i) May prevent a Belgian entity from attaining a reasonable profit and may even threaten the existence of said entity, without a correction mechanism being available, thereby violating the right to property;
- (ii) May prevent a Belgian entity to freely use the economic, technical and financial resources available to it and may adversely affect its competitive position, creditworthiness and even its viability, thereby violating the right to conduct a business and the general principles of legal certainty;
- (iii) Imposes a tax liability on a Belgian entity for undertaxed profits of other entities without considering the financial capacity of this Belgian entity, thereby treating entities with a different financial capacity in a similar manner, which violates the non-discrimination principle;
- (iv) Has no real and reasonable connection with the Belgian entity, which violates the principle of territoriality.

By Interim Judgment No. 104/2025 of July 17, 2025, the Constitutional Court referred the case to the CJEU for a preliminary ruling, raising the following questions:

“Do Articles 12 to 14 of [the Pillar Two Directive] — insofar as these provisions require Member States to subject group entities established in the Union that are part of an MNE group to a UTPR top-up tax, thereby making those entities liable for undertaxed profits realized by other group entities in another jurisdiction, and without making any distinction based on the financial capacity of those liable group entities

⁴¹⁰ Arguably, while the extension to domestic situations is likely to remove legal (“formal”) discrimination, it would not necessarily prevent factual (“hidden”) discrimination where either a high-tax jurisdiction is involved (so that the collection of the top-up tax would de facto affect foreign profits and hardly ever arise with regard to profits of CEs in that jurisdiction) and/or where none or only few large-scale domestic groups exist (e.g., in smaller economies where the € 750 million revenue might hardly be reached by purely domestic operations). In those cases, the GloBE rules may then well apply only (or at least mostly) to international groups. That said, it remains questionable whether a factual discrimination exists and if it would be sufficient to constitute a “manifest error” of the Directive.

— violate Articles 15, 16, 17, 20 and 21 of the Charter of Fundamental Rights of the European Union, Articles 49 and 56 of the Treaty on the Functioning of the European Union, the principle of legal certainty, and the principle of fiscal territoriality?”

If the CJEU were to declare the UTPR provisions to be incompatible with EU primary law (for example, the right to property), such incompatibility would, in principle, extend to the national Member States’ legislation implementing the Pillar Two Directive UTPR provisions. If, in contrast, the CJEU were to declare the UTPR provisions invalid based on the principle of legal certainty and/or the principle of fiscal territoriality (neither of which is a source of EU primary law), this would not necessarily result in the national UTPR implementing legislation being inapplicable as a matter of EU law; instead, such inapplicability would depend on the hierarchy of those principles within the legal systems of the EU Member States.

On the other hand, the introduction and implementation of the OECD Side-by-Side System (see VII.P., below) may arguably result in the UTPR issue raised by the AFECC becoming hypothetical and moot, since, under the agreement, U.S. companies would be excluded from the application of Pillar Two (including the UTPR). Whether this might induce the Belgian Constitutional Court to withdraw its request for a preliminary ruling is doubtful as there is no procedure available to that end, unless the initial plaintiff, i.e., the AFEC in the case at hand, would take the initiative for such withdrawal (which appears to be highly unlikely). Nor is it likely that the CJEU would hold that there is no longer a need to rule on the questions raised in the request as, in principle, the Court is to rule on the legislation as it stood at the time of the request, without taking into account amendments (such as the OECD Side-by-Side System) that are posterior to the request.⁴¹¹

(2) *Assessment of EU Law Compatibility of the (Implementation of the) OECD Side-by-Side System (Side-by-Side Safe Harbor and UPE Safe Harbor)*

(a) *The OECD Side-by-Side System*

See the discussion at VII.P., below.

(b) *Article 32 of the Pillar Two Directive as Adequate and Sufficient Legal Basis to Implement the OECD Side-by-Side System?*

On January 12, 2026, the European Commission published a notice in the *Official Journal* acknowledging the OECD Inclusive Framework Agreement on Safe Harbors and confirming, after expressly referring to Article 32 of the Pillar Two Directive and its application in the context thereof, that all the Member States consented to them.⁴¹² With the implication that,

in the Commission’s opinion, the Side-by-Side (SbS) System can also be considered a safe harbor under Article 32 of the Pillar Two Directive.⁴¹³

The question arises whether Article 32 of the Pillar Two Directive may be considered as offering an adequate and sufficient legal basis for purposes of introducing the SbS System at the EU level (and, in derivation therefrom, at the level of the domestic legislation of EU Member States).⁴¹⁴ Inherently connected to this question are the questions whether reliance on Article 32 of the Pillar Two Directive for purposes of introducing the SbS System raises EU constitutional and/or EU institutional responsibility issues. These questions will be addressed in what follows.

Article 32 of the Pillar Two Directive states that, by way of derogation from Articles 26 to 31 (setting out applicable rules on the computation of the effective tax rate and the top-up tax), Member States shall ensure that, at the election of the filing constituent entity, the top-up tax due by a group in a jurisdiction shall be deemed to be zero for a fiscal year if the effective level of taxation of the constituent entities located in that jurisdiction fulfils the conditions of a qualifying international agreement on safe harbors. A “qualifying international agreement on safe harbors” is thereby defined as an international set of rules and conditions which all Member States have consented to and which grants groups in the scope of the Pillar Two Directive the possibility of electing to benefit from one or more safe harbors for a jurisdiction.

Starting point of the analysis is the assessment of the legal status of the IF’s GloBE Administrative Guidelines and, as those Guidelines will be incorporated in the OECD GloBE Model Rules, that of the OECD GloBE Model Rules.

The IF’s GloBE Administrative Guidelines, intended to provide interpretive guidance in order to ensure consistent and common interpretation of the OECD GloBE Model Rules, undeniably constitute soft law. In the author’s opinion, the same holds true for the GloBE Model Rules into which, as indicated above, the Administrative Guidelines will be incorporated in due course. Admittedly, the OECD GloBE Model Rules are at the crossroads of soft and hard law with as argument that, although implementation of those Rules by the jurisdictions that joined the IF is not mandatory,⁴¹⁵ if they decide to implement the Rules into their domestic legislation they must do so according to the “common approach” that was agreed upon by the IF’s members, thereby putting, to a certain extent, a “sense of

Cyprus (which is not a member of the IF) acting as last Member State, all the Member States consented to the OECD SbS Package guidance.

⁴¹³ Notice on The OECD Inclusive Framework Agreement on Safe Harbors and the Pillar Two Directive, OJ C/2026/253 of January 12, 2026.

⁴¹⁴ This is obviously the position of the EU Commission, as confirmed by Benjamin Angel, Head of DG TAXUD, at the September 18, 2025 CFE Tax Advisors Europe Tax Symposium “Taxation in Transition: Compliance, Rights & Innovation in a High-Data World”, where he reportedly stated that: “[w]hatsoever is agreed and labelled safe harbor in the OECD is automatically part of Union law and binding on Member States”. See Loyens & Loeff, “EU Tax Law Highlights of 2025”, annual edition of EU Tax Alert at <https://www.loyensloeff.com/eu-tax-alert-overview-2025.pdf>.

⁴¹⁵ See OECD Commentary to the GloBE Model Rules, 9 para. 1 emphasizing that the GloBE Model Rules were created as a draft that the jurisdictions that wish to implement them can use as an example guiding their domestic implementation.

⁴¹¹ See, to that effect, although in another context, Case C-524/23, *Commission v. Belgium*, regarding the incompatibility of the prior Belgian CFC rules with the EU Anti-Tax Avoidance Directive (ATAD).

⁴¹² Initially, on September 24, 2025, during the discussions regarding the state of play on Pillar Two at the meeting of the EU Council’s high-level working party on tax questions, nine Member States had voiced legal doubts about the possibility of implementing the Side-by-Side (SbS) System agreed to by the G7 and the OECD/Inclusive Framework (IF) via the Article 32 mechanism and without the need of amending the Pillar Two Directive. Eventually, with

obligation” on those implementing jurisdictions.⁴¹⁶ The fact remains, however, that no implementation obligation *per se* really exists as the IF does not have the power to create laws and bind States; nor is the “common approach” part of the law of any country or treaty signed by any Parliament. Consequently, the GloBE Model Rules cannot be considered as amounting to hard law and must be considered by default as a soft law instrument.⁴¹⁷

Against this backdrop, it is fair to conclude that both the IF’s GloBE Administrative Guidelines and the OECD GloBE Model Rules amount to soft law. Use of the Article 32 mechanism “to acknowledge and confirm” the SbS System thus has the effect of converting soft law into binding (hard) law. Under the Article 32 mechanism, Member States are indeed obligated to transpose the SbS System into their domestic legislation.

According to the author, this obviously goes beyond the scope of the Article 32 mechanism, which is generally considered to be intended (and limited) to bringing technical simplification.

Admittedly, within the scope of the OECD GloBE Model Rules, the Article 32 mechanism has in the past served as legal basis for the endorsement of temporary safe harbors, but these safe harbors were intended to address mere technical issues. However, this is fundamentally different from endorsement based on Article 32 of the SbS System which introduces an outright exemption from the IIR and UTPR for qualifying MNE Groups. Using the Article 32 mechanism in the latter case poses a problem of constitutionality in that it ignores the necessary intervention of the EU legislature to adopt what is no less than a substantive amendment of the Pillar Two Directive.⁴¹⁸ Certain authors have rightfully labelled this problem in an imagery way as the use of Article 32 as a constitutional Trojan horse.⁴¹⁹

⁴¹⁶ See, Verreckt, A., *The legal status of GloBE Model Rules and the administrative Guidance*, <https://shop.lindeverlag.at/onlineprodukt/the-global-minimum-tax-selected-issues-on-pillar-two-4129/onb/leseprobe/ONB101415.pdf>.

⁴¹⁷ *Ibid.*

⁴¹⁸ As indicated, an amendment of the Pillar Two Directive would require intervention by the EU legislature and unanimity among Member States. In a pragmatic (albeit non-legal) approach, it could be argued that endorsement of the SbS System by the EU Commission through the Article 32 mechanism of the Pillar Two Directive, rather than through an amendment of that Directive is an artificial discussion as the Notice expressly states that all Member States have consented to the SbS Package, including the SbS System — whereby such consent could then be assimilated to “unanimity”. This argument, however, is in our opinion not convincing as it ignores or at least makes abstraction of the core question as to whether the EU Commission has the legal competence to implement the SbS System through a notice based on Article 32 of the Pillar Two Directive.

⁴¹⁹ Weber, D., *A full carve-out for U.S. groups for Pillar 2: an EU Constitutional Trojan Horse?*, <https://legalblogs.wolterskluwer.com/international-tax-law-blog/a-full-carve-out-for-us-groups-for-pillar-2-an-eu-constitutional-trojan-horse/>; *Id.*, *The Pillar 2 — Side-by-Side Package: A Structural Breach of EU Tax Law*, <https://legalblogs.wolterskluwer.com/international-tax-law-blog/the-pillar-2-side-by-side-package-a-structural-breach-of-eu-tax-law/>, where the author also raises State aid concerns in that the SbS Safe Harbor and the UPE Safe Harbor may effectively be considered to constitute selective State aid — a concern that in our view is rather unlikely to crystallize as it is the Commission itself that endorsed those safe harbors through the Article 32 mechanism, thereby potentially opening the door for affected U.S. MNE’s to invoke reliance on the principle of legitimate expectations; Korving, J., *Side-by-Side as discordant constitutional element: what can EU Member States do?*, <https://legalblogs.wolterskluwer.com/international-tax-law-blog/side-by-side->

The constitutionality issue is further underscored by an institutional “delegation of powers” issue arising from the so-called Meroni doctrine developed by the CJEU. In *Meroni v. High Authority*,⁴²⁰ the Court held that “[t]he consequences resulting from a delegation of powers are very different depending on whether it involves clearly defined executive powers the exercise of which can, therefore, be subject to strict review in the light of objective criteria determined by the delegating authority, or whether it involves a discretionary power, implying a wide margin of discretion which may, according to the use which is made of it, make possible the execution of actual economic policy. A delegation of the first kind cannot appreciably alter the consequences involved in the exercise of the powers concerned, whereas a delegation of the second kind, since it replaces the choices of the delegator by the choices of the delegate, brings about an actual transfer of responsibility.” In other words, the EU legislature may delegate certain executive powers, but it cannot delegate discretionary powers involving political choices that would shift institutional responsibility. The use of the Article 32 mechanism precisely produces that effect as it intrinsically presupposes a delegation of powers to an external international forum, i.e., the IF.⁴²¹

In conclusion, in the author’s opinion, the use of the Article 32 of the Pillar Two Directive “to acknowledge and confirm” the SbS System is unconstitutional from an EU law perspective and, in addition, is incompatible with the EU institutional framework as enshrined in the TEU and the TFEU.

As indicated in II.G.1.a., above, Article 263(1) of the TFEU empowers the CJEU to review the legality of, *inter alia*, acts of the Commission. In the case at hand, logical applicants to bring an action under Article 263 would be the European Parliament or, less likely in the author’s opinion, the Council.⁴²² This would open the door for non-privileged parties, such as a Member State, to bring an action under Article 277 of the TFEU. Having regard to the fact that the Notice was published in the EU *Official Journal* on January 12, 2026, a hurdle to such action is obviously the two-month time period condition to bring an action under Article 263 of the TFEU.

Once the Article 263 deadline expired, the remaining option, applicable without any limitation in time, would be the preliminary ruling route of Article 267 of the TFEU. As indi-

as-discordant-constitutional-element-what-can-eu-member-states-do/; van der Vlugt, S., *Accommodation at Any Cost. Why the Measures to Save the Global Minimum Tax Might Prove Unconstitutional*, <https://verfassungsblog.de/eu-global-minimum-tax-legality/>.

⁴²⁰ Case 9-56, *Meroni v. High Authority*. Although the subject-matter of heavy debate, the Meroni doctrine was reinforced in Case 98/80, *Romana* (extension to legislative acts); Case C-270/12, *United Kingdom v. Parliament and Council* (ESMA short selling case) and Case C-551/22 P, *Commission v. SRB*.

⁴²¹ Weber, D., *A full carve-out for U.S. groups for Pillar 2: an EU Constitutional Trojan Horse?*, <https://legalblogs.wolterskluwer.com/international-tax-law-blog/a-full-carve-out-for-us-groups-for-pillar-2-an-eu-constitutional-trojan-horse/>; *Id.*, *The Pillar 2 — Side-by-Side Package: A Structural Breach of EU Tax Law*, <https://legalblogs.wolterskluwer.com/international-tax-law-blog/the-pillar-2-side-by-side-package-a-structural-breach-of-eu-tax-law/>; Korving, J., *Side-by-Side as discordant constitutional element: what can EU Member States do?*, <https://legalblogs.wolterskluwer.com/international-tax-law-blog/side-by-side-as-discordant-constitutional-element-what-can-eu-member-states-do/>.

⁴²² As of March 17, 2026, Members of the European Parliament (MEPs) and tax campaigners are raising concerns over significant projected revenue losses stemming from the OECD SbS deal.

cated, this would require the intervention of an EU Member State national court or tribunal (willing to request a preliminary ruling and with the power to determine the very object of the questions to refer), which in turn assumes that (first) an action is brought by an interested party before such court or tribunal. Obviously, the key question in this respect is who could be an interested party. In all likelihood, this will not be a U.S. MNE that is eligible for the SbS and UPE safe harbors. At least theoretically, an interested party could be an MNE of another jurisdiction that has no IIR and pursues equal treatment.

In other words, as of this writing, this story perhaps will continue to develop over the coming months.

c. The Specific Case of the Anti-Avoidance Tax Directive (ATAD)

See the discussion in VI.B.7., below.

2. Harmonization of Secondary Tax Legislation

a. General

In the direct tax area, the question of the relationship between the fundamental freedoms and provisions of harmonizing secondary legislation pertains, in particular, to the interaction between:

- (i) The freedom of establishment and the free movement of capital; and
- (ii) The (harmonizing) provisions contained in the relevant tax directive.

In general terms, it is settled case-law of the CJEU that any national measure in an area that has been the subject of exhaustive harmonization at the EU level must be assessed in the light of the provisions of that harmonizing measure, and not in the light of the provisions of primary law.⁴²³

⁴²³ Joined Cases C-504/16 and C-613/16, *Deister Holding and Juhler Holding* (re: Article 1(2) of the Parent-Subsidiary Tax Directive, see *infra*); Case C-305/17, *FENS* (“Article 11(7) of Directive 2003/54 concerning common rules for the internal market in electricity and Article 5 of Directive 2005/89 concerning measures to safeguard security of electricity supply and infrastructure investment did not exhaustively harmonize the fields which they govern [and, hence,] it is appropriate to proceed to the interpretation of Articles 28 and 30 TFEU [(free movement of goods)]”); Case C-6/16, *Eqiom and Enka* (re: Article 1(2) of the Parent-Subsidiary Tax Directive, see *infra*); Case C-14/16, *Euro Park Service* (re: Article 11(1)(a) of the Merger Tax Directive, see *infra*); Case C-475/12, *UPC DTH* (“EU law has not been fully harmonized in the electronic communications services sector and, accordingly, the national legislation at issue in the main proceedings must be considered in the light of Article 56 TFEU [(freedom to provide services)]”); Case C 265/12, *Citroën Belux* (“Article 3(9) of Directive 2005/29 [concerning unfair business-to-consumer commercial practices in the internal market] — as indicated by recital 9 in the preamble to that directive — provides specifically that, in relation to financial services, Directive 2005/29 does not exhaustively harmonize the existing law and leaves Member States freedom of action, which they must exercise in accordance with the Treaty. (...) It is therefore necessary to consider whether the [matter at issue in the main proceedings] is consistent with Article 56 TFEU [(freedom to provide services)]”). Case C-573/12, *Ålands Vindkraft* (“[T]he harmonisation brought about by Directive 2009/28 [on the promotion of the use of energy from renewable sources] in the field of support schemes was of such a kind as to preclude an examination of their compatibility with Article 34 TFEU.”); Case C-322/01, *Deutscher Apothekerverband* (“A national measure in a sphere which has been the subject of exhaustive harmonization at Community level must be assessed in the light of the provisions of the harmonising measure and not those of the Treaty”); Case C-324/99, *DaimlerChrysler*: “It (...) follows from the context in which Regulation (EEC) No 259/93 [on ship-

Paraphrasing the words of Advocate General Kokott, transposed to the direct tax context: “[t]he hierarchy of norms is clear. The [relevant tax] directive is to be measured against the fundamental freedoms, and not vice versa. (, ,) First, the Court reviews the compatibility of secondary law with primary law. Second, the foregoing statement is correct in cases where there is no doubt as to the compatibility of secondary law with primary law. This would mean that the secondary law, as a *lex specialis*, must be given precedence. If it already follows from this that the contested [national tax measure] is contrary to EU law, there is no need also to examine whether it is incompatible with primary law.”

In other words, where there is no doubt as to the compatibility of secondary law with primary law, it is appropriate to:

- (i) Examine the question(s) referred by the referring court to the CJEU insofar as it (they) concern(s) the interpretation of the relevant tax directive; and
- (ii) Subsequently, in the absence of exhaustive harmonization, examine those questions insofar as they concern the relevant fundamental freedom.⁴²⁴

b. Merger Tax Directive

Applying the above principles, the CJEU found in *Euro Park Service*⁴²⁵ that Article 11(1)(a) of the Merger Tax Directive did not achieve exhaustive harmonization at the level of the EU, as it followed clearly from the wording of that provision that it was not the case.

- (i) First, as was apparent from its wording, the provision allowed Member States to refuse to apply, or withdraw the benefit of all or part of, the provisions of the Directive only where the operation coming within its scope, such as a merger involving the companies of various Member States (a cross-border merger), had as its principal objective, or one of its principal objectives, tax evasion or tax avoidance.

- (ii) Second, as part of that reservation of competence, Article 11(1)(a) of the Directive allowed the Member States to provide for a presumption of tax evasion or tax avoidance in cases where the merger was not carried out for valid commercial reasons.

ments of waste] was adopted, from its nature, from the aims which it pursues and from its content, that it regulates in a harmonised manner, at Community level, the question of shipments of waste in order to ensure the protection of the environment. Accordingly, any national measure relating to shipments of waste must be assessed in the light of the provisions of the Regulation and not [in the light] of [the free movement of goods]”; Case C-5/94, *Hedley Lomas* (“Recourse to [the Treaty provision allowing] the maintenance of restrictions on the free movement of goods (...) is no longer possible where Community directives provide for harmonization of the measures necessary to achieve the specific objective which would be furthered by reliance upon this provision”); Case C-37/92, *Vanacker and Lesage* (“[S]ince the question of the collection of waste oil has been regulated in a harmonized manner at Community level by [Directive 75/439/EEC on the disposal of waste oils], any national measure relating thereto must be assessed in the light of the provisions of the directive and not [in the light] of the [free movement of goods]”).

⁴²⁴ Case C-257/20, *Viva Telecom Bulgaria*; see also the discussion at E.6.f., above.

⁴²⁵ Case C-14/16, *Euro Park Service*.

(iii) Lastly, concerning the exercise of that option and the application of that presumption, it was apparent from the case law of the Court that, in the absence of more detailed EU law provisions in that regard, it was for the Member States, observing the principle of proportionality, to determine the provisions required for the purposes of applying Article 11(1)(a) of the Directive.

In those circumstances, it had to be held that the provision in question was not intended, as regards the measures designed to counter tax evasion and avoidance, to achieve exhaustive harmonization at the EU level.

Consequently, insofar as Article 11(1)(a) of the Directive did not achieve exhaustive harmonization, EU law allowed for the assessment of the compatibility of national legislation, such as that at issue in the main proceedings, in the light of primary law, where that legislation was adopted to transpose into national law the option provided for in that provision.

c. Parent-Subsidiary Tax Directive

Likewise, in *Egiom and Enka*⁴²⁶ and in *Deister Holding and Juhler Holding*,⁴²⁷ the CJEU held that Article 1(2) of the Parent-Subsidiary Tax Directive did not achieve exhaustive harmonization as it was clear from the wording of that provision that it was not the case.

Article 1(2) of the Directive recognized solely the Member States' power to apply domestic or agreement-based provisions required for the prevention of fraud and abuse. Such provisions could therefore be assessed in the light of primary EU law.

Accordingly, national legislation, such as that at issue in the main proceedings, adopted in order to implement Article 1(2) of the Directive, could be assessed not only in the light of the provisions of the Directive, but also the relevant provisions of primary law (here, Article 49 of the TFEU).

A similar reasoning was followed by Advocate General Kokott in her Opinion in *Schneider Electric and Others*⁴²⁸ with regard to Article 7(2) of the Parent-Subsidiary Tax Directive. According to the Advocate General, the Directive "shall not affect the application of domestic or agreement-based provisions designed to eliminate or lessen economic double taxation of dividends, in particular provisions relating to the payment of tax credits to the recipients of dividends."

(i) First, if Article 7(2) of the Directive were to permit a system without tax credits such as that at issue in *Schneider Electric and Others* (where a French tax measure providing for a levy when a parent company redistributed profits that had been distributed to it by subsidiaries established in another Member State, with a view to ensuring

the correct implementation of a scheme designed to eliminate economic double taxation of dividends), there would be doubts as to its compatibility with the fundamental freedoms.

(ii) Second, Article 7(2) of the Directive did not affect the "application of domestic or agreement-based provisions" in that regard.

Thus, there was no exhaustive harmonization by means of the Directive.

Accordingly, as long as the tax credit, offset against the advance payment, continued to depend on whether the distributing subsidiary was established in France or in another Member State, the French system of advance payments and tax credits was contrary to EU (primary) law. Nor could Article 7(2) of the Directive alter this fact.

d. Pillar Two Directive

The relevant operative provisions of the Pillar Two Directive are mandatory for the Member States, without the Directive giving the Member States explicit options for any down- or upward derogations.

Arguably, therefore, the harmonization achieved through the Pillar Two Directive should be considered to be "exhaustive," implying that the Member States' domestic tax laws implementing the Directive should only be tested against the Pillar Two Directive itself, and not directly against the fundamental freedoms (see II.G.2.a., above).

3. National Tax Measures Falling "Out of Scope" of Relevant Tax Directive

If, following an examination, it is found that the national tax measure at issue falls outside the scope of the relevant tax directive, it remains subject to assessment under the relevant fundamental freedom.

An illustration of this may be found in *Viva Telecom Bulgaria*,⁴²⁹ in which the CJEU found the requirements for the application of the Interest and Royalty Directive (beneficial ownership requirement) and the Parent-Subsidiary Tax Directive (distribution of profits requirement) not to be met in a case where the Bulgarian tax authorities claimed, based on a domestic anti-abuse provision, that fictitious or deemed interest — on which a 10% withholding was due — should be imputed in the context of a convertible interest-free loan granted by a Luxembourg-based parent company to its Bulgarian subsidiary.

Consequently, it assessed the case in the light of the fundamental freedoms (in particular, the free movement of capital principle).⁴³⁰

⁴²⁶ Case C-6/16, *Egiom and Enka*.

⁴²⁷ Joined Cases C-504/16 and C-613/16, *Deister Holding and Juhler Holding*.

⁴²⁸ Case C-556/20, *Schneider Electric and Others*.

⁴²⁹ Case C-257/20, *Viva Telecom Bulgaria*.

⁴³⁰ See also the discussion at E.6.f., above.

III. Merger Tax Directive

A. Introduction

Executive Summary

This Section discusses the Merger Tax Directive, introducing a common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets, exchanges of shares concerning companies of different Member States and the transfer of the registered office of certain EU law entities.

The common system essentially establishes a regime of tax neutrality allowing the taxation of income, profits and capital gains arising when businesses are reorganized to be deferred, provided certain conditions are fulfilled. The common system is associated with a (specific) anti-abuse rule, the scope of which has been clarified by the CJEU on a number of occasions.

On July 23, 1990, the Council adopted Directive 90/434/EEC 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. Council Directive 90/434/EEC has been substantially amended several times and, in the interests of clarity and rationality, it was codified by Council Directive 2009/133/EC of October 19, 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 a European company (*Societas Europaea* or SE) or a European Cooperative Society (SCE) between Member States (the “Merger Tax Directive”).

Generally, the aim of the Merger Tax Directive is to create within the European Union conditions analogous to those of an internal market, and to remove restrictions, disadvantages or distortions arising from the existing tax provisions of the Member States that disadvantage reorganizations of companies (such as mergers, divisions, partial divisions and other similar types of transactions) where companies of two or more Member States are involved.⁴³¹ This objective is attained by the creation of a system that allows the taxation of income, profits and capital gains arising where businesses are reorganized to be deferred, provided certain conditions are fulfilled.

The Merger Tax Directive, however, is not designed to prohibit or otherwise preclude exit taxation: the question of how far an exit tax is in fact permissible in the cases covered by the Merger Tax Directive must ultimately be clarified based on primary legislation (more specifically, the freedom of es-

tablishment contained in Article 49 of the TFEU)⁴³² and, since 2020, (also) based on the ATAD 1 exit tax measure.⁴³³

B. Scope of Application

The Merger Tax Directive applies to:

- (i) Mergers, divisions, partial divisions, transfers of assets and exchanges of shares involving companies from two or more Member States; and
- (ii) Transfers of the registered office from one Member State to another Member State of an SE, as established in Council Regulation (EC) No. 2157/2001 on the Statute for a European company (SE), or an SCE, as established in Council Regulation (EC) No. 1435/2003 on the Statute for a European Cooperative Society (SCE).⁴³⁴

It follows that the Merger Tax Directive requires an EU cross-border restructuring (and thus restructuring operations involving at least two Member States) for the common system that it encompasses to apply.⁴³⁵

1. Material Scope — Types of Operations

A “merger” means an operation whereby:

- (i) One or more companies, on being dissolved without going into liquidation, transfer all their assets and liabilities to another existing company in exchange for the issue to their shareholders of securities representing the capital of that other company, and, if applicable, a cash payment not exceeding 10% of the nominal value, or, in the absence of a nominal value, of the accounting par value of those securities (merger by way of absorption);
- (ii) Two or more companies, on being dissolved without going into liquidation, transfer all their assets and liabilities to a company that they form, in exchange for the issue to their shareholders of securities representing the capital of that new company, and, if applicable, a cash payment not exceeding 10% of the nominal value, or in the absence of a nominal value, of the accounting par value of those securities (merger by formation of a new company); or
- (iii) A company, on being dissolved without going into liquidation, transfers all its assets and liabilities to the company holding all the securities representing its capital (merger by acquisition of a 100% subsidiary by its parent).⁴³⁶

⁴³² Cf. Case C-292/16, *A Oy*: The freedom of establishment precludes a national (exit tax) provision (intended to implement Merger Tax Directive, Art. 10(2)) that imposes immediate taxation in the Member State of the transferring company where the PE transferred and the receiving company are situated in another Member State, where such taxation does not apply in a similar domestic case. Comp., Case C-371/10, *National Grid*. On freedom of establishment and exit taxes, see also, II.E.4.f., above.

⁴³³ See, VLB.3., below.

⁴³⁴ Merger Tax Directive, Art. 1(a) and (b).

⁴³⁵ However, in Case C-48/11, *A Oy*, the CJEU decided that, subject to certain conditions, the benefits under the Merger Tax Directive should be expansively applied beyond the scope of that Directive for the sake of the fundamental freedoms, i.e., the freedom of establishment under the EEA Agreement requires tax neutral treatment of exchanges of shares between EU and EEA companies.

⁴³⁶ Merger Tax Directive, Art. 2(a).

⁴³¹ Council Directive 2009/133/EC of October 19, 2009 (“Merger Tax Directive”), Recital (2).

A “division” means an operation whereby a company, on being dissolved without going into liquidation, transfers all its assets and liabilities to two or more existing or new companies, in exchange for the *pro rata* issue to its shareholders of securities representing the capital of the companies receiving the assets and liabilities, and, if applicable, a cash payment not exceeding 10% of the nominal value or, in the absence of a nominal value, of the accounting par value of those securities.⁴³⁷

A “partial division” means an operation whereby a company transfers, without being dissolved, one or more branches of activity, to one or more existing or new companies, leaving at least one branch of activity in the transferring company, in exchange for the *pro rata* issue to its shareholders of securities representing the capital of the companies receiving the assets and liabilities, and, if applicable, a cash payment not exceeding 10% of the nominal value or, in the absence of a nominal value, of the accounting par value of those securities.⁴³⁸

A “transfer of assets” is an operation whereby a company transfers without being dissolved all or one or more branches of its activity to another company in exchange for the transfer of securities representing the capital of the company receiving the transfer.⁴³⁹ For these purposes, a “branch of activity” means all the assets and liabilities of a division of a company that, from an organizational point of view, constitute an independent business, that is to say an entity capable of functioning by its own means.⁴⁴⁰ Elaborating on these definitions, the Court of Justice of the European Union (CJEU) has decided that a “transfer of assets” must encompass all the assets and liabilities relating to a branch of activity. With regard to the required independence of the branch of activity, the CJEU has held that the independent operation of the business must be assessed primarily from a functional point of view and only secondarily from a financial point of view, i.e., the assets transferred must be able to operate as an independent business undertaking without needing to have recourse, for that purpose, to additional investments or transfers of assets. The operation of a business is not independent, from a financial point of view, when the receiving company’s income is insufficient to cover its financial obligations and, consequently, as a permanently loss-making activity lacks the required financial independence — such an activity does not qualify as a “branch of activity.” In other words, the assets and liabilities relating to a branch of activity should be transferred in their entirety. This would not be the case, for example, if the transferring company were to retain the proceeds of a large loan contracted by it and to transfer the obligations deriving from that loan to the company to which the assets were transferred, as in such an event those two elements would be dissociated.⁴⁴¹

An “exchange of shares” means an operation whereby a company acquires a holding in the capital of another company such that it obtains a majority of the voting rights in that company, or, holding such a majority, acquires a further holding, in exchange for the issue to the shareholders of the latter company, in exchange for their securities, of securities represent-

ing the capital of the former company, and, if applicable, a cash payment not exceeding 10% of the nominal value or, in the absence of a nominal value, of the accounting par value of the securities issued in exchange.⁴⁴² In *Leur-Bloem*,⁴⁴³ the CJEU ruled that it is clear from this definition and from the general scheme of the Directive that the common tax rules that it lays down apply without distinction to all mergers, divisions, transfer of assets or exchanges of shares irrespective of the reasons, whether financial, economic or simply fiscal, for those operations. Consequently, the fact that the acquiring company does not itself carry on a business or that the same natural person, who was the sole shareholder and director of the companies acquired, becomes the sole shareholder and director of the acquiring company, does not prevent the operation from being treated as an exchange of shares within the meaning of the Directive. Similarly, it is not necessary, for the operation to be treated as an exchange of shares within the meaning of the relevant provision, for there to be a permanent merger, from a financial and economic point of view, of the business of two companies into a single unit. In *Kofoed*,⁴⁴⁴ which concerned an exchange of shares quickly followed by the distribution of a dividend, the question arose as to whether the dividend payment made shortly after the exchange of shares should be regarded as forming part of that acquisition, i.e., constituted a “cash payment” as a result of which the 10% threshold would have been exceeded, thus rendering the exchange of shares ineligible for the tax deferral regime under the Directive. The CJEU found that the concept of “cash payment” should be considered to cover monetary payments having the characteristics of genuine consideration for the acquisition, namely payments agreed upon in a binding manner in addition to the allotment of securities representing the share capital of the acquiring company; in other words, a “cash payment” is a payment that is part and parcel of the consideration paid by the acquiring company to the shareholders of the acquired company. In contrast, a monetary payment made by the acquiring company cannot be classified as a “cash payment” merely because of a certain temporal or other link to the acquisition, or possible fraudulent intent. Therefore, it is necessary to ascertain in each case, having regard to the circumstances as a whole, whether the payment in question has the characteristics of binding consideration for the acquisition.

For the above purposes, “transferring company” means the company transferring its assets and liabilities or transferring all or one or more branches of its activity.⁴⁴⁵ “Receiving company” means the company receiving the assets and liabilities or all, or one or more branches of the activity of the transferring company.⁴⁴⁶ “Acquired company” means the company in which a holding is acquired by another company by means of an exchange of securities.⁴⁴⁷ “Acquiring company” means the com-

⁴⁴² Merger Tax Directive, Art. 2(e).

⁴⁴³ Case C-28/95, *Leur-Bloem*.

⁴⁴⁴ Case C-321/05, *Kofoed* (the CJEU concluded that, as there was nothing in the case file to show that the dividend in question formed part of the consideration for the acquisition, the exchange of shares was not to be subject to taxation on these grounds).

⁴⁴⁵ Merger Tax Directive, Art. 2(f).

⁴⁴⁶ Merger Tax Directive, Art. 2(g).

⁴⁴⁷ Merger Tax Directive, Art. 2(h).

⁴³⁷ Merger Tax Directive, Art. 2(b).

⁴³⁸ Merger Tax Directive, Art. 2(c).

⁴³⁹ Merger Tax Directive, Art. 2(d).

⁴⁴⁰ Merger Tax Directive, Art. 2(j).

⁴⁴¹ Case C-43/00, *Andersen og Jensen*.

pany that acquires a holding by means of an exchange of securities.⁴⁴⁸

Finally, a “transfer of the registered office” means an operation whereby an SE or an SCE (see XIII., below), without winding up or creating a new legal person, transfers its registered office from one Member State to another Member State.⁴⁴⁹

2. Personal Scope — Eligible (Types of) Companies

In principle,⁴⁵⁰ only “companies from a Member State” are eligible for the common system of taxation established by the Merger Tax Directive.

A “company from a Member State” is any company that:

- (i) Takes one of the forms listed in Annex I, Part A of the Merger Tax Directive;
- (ii) According to the tax laws of a Member State is considered to be resident in that Member State for tax purposes and, under the terms of a double taxation agreement concluded with a third country, is not considered to be resident for tax purposes outside the European Union; and
- (iii) Is subject to one of the taxes listed in Annex I, Part B of the Merger Tax Directive, without the possibility of an option to be, or the possibility of being, exempt, or to any other tax that may be substituted for any of those taxes.⁴⁵¹

C. Common System of Taxation

1. Rules Applicable to Mergers, Divisions, Partial Divisions, Transfers of Assets and Exchanges of Shares

a. At the Level of the Transferring or Acquired Company and at the Level of the Receiving Company

Under the common system of taxation, a merger, division or partial division does not give rise to any taxation of capital gains calculated by reference to the difference between the real value of the assets and liabilities transferred and their value for tax purposes.⁴⁵² For this purpose, “value for tax purposes” means the value based on which any gain or loss would have been computed for purposes of tax on the income, profits or capital gains of the transferring company if such assets or liabilities had been sold at the time of the merger, division or partial division but independently of it.⁴⁵³

“Transferred assets and liabilities” means those assets and liabilities of the transferring company that, in consequence of the merger, division or partial division, are effectively connected with a permanent establishment (PE) of the receiving company in the Member State of the transferring company⁴⁵⁴ and

play a part in generating the profits or losses taken into account for tax purposes (i.e., the profits should be subject to corporate income tax in the Member State of the transferring company).⁴⁵⁵ In other words, the system of tax deferral established by the Merger Tax Directive applies only to those transferred assets and liabilities that are (and remain) effectively connected to a PE in the Member State of the transferring company. It follows that capital gains with respect to assets and liabilities, including goodwill, that must be attributed to the (new) head office in the Member State of the receiving company may be taxed on the merger, division or partial division and, likewise, that mergers, divisions or partial divisions that do not result in (the maintaining of) a PE (for example, in the case of holding companies) may be subject to taxation. Thus, as indicated, the Merger Tax Directive does not in any sense preclude exit taxation (see III.A., above).

Where a Member State considers a nonresident transferring company to be fiscally transparent based on that Member State’s assessment of the legal characteristics of that company arising from the law under which it is constituted and therefore taxes the shareholders on their share of the profits of the transferring company as and when those profits arise, that Member State must refrain from taxing any income, profits or capital gains calculated by reference to the difference between the real value of the assets and liabilities transferred and their value for tax purposes.⁴⁵⁶

The regime of “tax neutrality” at the level of the transferring or acquired company applies only if the receiving company computes any new depreciation and any gains or losses with respect to the assets and liabilities transferred in accordance with the rules that would have applied to the transferring company or companies if the merger, division or partial division had not taken place.⁴⁵⁷ If, under the laws of the Member State of the transferring company, the receiving company is entitled to have any new depreciation or any gains or losses with respect to the assets and liabilities transferred computed on a different basis, the “tax neutrality” does not apply to the assets and liabilities with respect to which that option is exercised.⁴⁵⁸

Where provisions or reserves properly constituted by the transferring company are partly or wholly exempt from tax and are not derived from PEs abroad, such provisions or reserves may be carried over, with the same tax exemption, by the PEs of the receiving company situated in the Member State of the

⁴⁴⁸ Merger Tax Directive, Art. 2(i).

⁴⁴⁹ Merger Tax Directive, Art. 2(k).

⁴⁵⁰ See, however, Case C-48/11, *A Oy*, where the CJEU decided that, subject to certain conditions, the benefits under the Merger Tax Directive should be expansively applied beyond the scope of that Directive for the sake of the fundamental freedoms, i.e., the freedom of establishment under the EEA Agreement requires tax neutral treatment of exchanges of shares between EU and EEA companies.

⁴⁵¹ Merger Tax Directive, Art. 3.

⁴⁵² Merger Tax Directive, Art. 4(1).

⁴⁵³ Merger Tax Directive, Art. 4(2)(a).

⁴⁵⁴ The PE accounts for the elements transferred at values corresponding to the book values previously shown in the accounts of the transferring company. It follows that the Merger Tax Directive precludes legislation of a Member State under which, in consequence of an exchange of shares, the shareholders of the acquired company are taxed on the capital gains arising from the transfer and the capital gain is deemed to correspond to the difference between the initial cost of acquiring the shares transferred and their market value, unless the acquiring company carries over the historical book value of the shares transferred in its own tax balance sheet (Case C-285/07, *A.T.*).

⁴⁵⁵ Merger Tax Directive, Art. 4(2)(b). A similar requirement applies in the context of the transfer of the registered office of a European company (*Societas Europaea* or SE) or a European Cooperative Society (SCE) (see below). The question arises as to whether this requirement may be considered to be compatible with the freedom of establishment (TFEU, Art. 49).

⁴⁵⁶ Merger Tax Directive, Art. 4(3).

⁴⁵⁷ Merger Tax Directive, Art. 4(4).

⁴⁵⁸ Merger Tax Directive, Art. 4(5).

transferring company, the receiving company thereby assuming the rights and obligations of the transferring company.⁴⁵⁹

To the extent that, if the merger, (partial) division, transfer of assets or exchange of shares operations were effected between companies from the Member State of the transferring company, the Member State would apply provisions allowing the receiving company to take over the losses of the transferring company that had not yet been exhausted for tax purposes, it must extend those provisions to cover the takeover of such losses by the receiving company's PEs situated within its territory.⁴⁶⁰

Where the receiving company has a holding in the capital of the transferring company, any gains accruing to the receiving company on the cancellation of its holding are not liable to any taxation. However, the Member States may derogate from this position if the receiving company has a holding of less than 15% or, from January 1, 2009, 10% in the capital of the transferring company (the initially applicable minimum holding percentage of 25% was amended in 2005 to link the provisions of the Merger Tax Directive with the provisions of the Parent-Subsidiary Directive).⁴⁶¹

In the case of a transfer of assets, the Merger Tax Directive leaves it to the Member States' discretion whether the fiscal neutrality from which the transferring company benefits is to be made subject to obligations to value the securities received in exchange, such as maintaining the continuity of values for tax purposes, provided those obligations do not have the consequence that the issue of those securities during the transfer of assets itself gives rise to taxation of the capital gains relating to those assets.⁴⁶²

b. At the Level of the Shareholders

On a merger, division or exchange of shares, the allotment of securities representing the capital of the receiving or acquiring company to a shareholder of the transferring or acquired company in exchange for securities representing the capital of the latter company does not, of itself, give rise to any taxation of the income, profits or capital gains of that shareholder.⁴⁶³ In the same vein, on a partial division, the allotment to a shareholder of the transferring company of securities representing the capital of the receiving company does not, of itself, give rise to any taxation of the income, profits or capital gains of that shareholder.⁴⁶⁴

Where a Member State considers a shareholder to be fiscally transparent based on that Member State's assessment of the legal characteristics of that shareholder arising from the law under which it is constituted and therefore taxes those persons having an interest in the shareholder on their share of the profits of the shareholder as and when those profits arise, that Member State must refrain from taxing those persons on income, profits or capital gains from the allotment of securities representing the capital of the receiving or acquiring company to the shareholder.⁴⁶⁵

The above rules apply only if the shareholder does not attribute to the securities received a value for tax purposes that is higher than the value the securities exchanged had immediately before the merger, division or exchange of shares or, in the case of a partial division, if the shareholder does not attribute to the sum of the securities received and those held in the transferring company, a value for tax purposes that is higher than the value the securities held in the transferring company had immediately before the partial division.⁴⁶⁶ Moreover, these rules do not prevent the Member States from taxing the gain arising on the subsequent transfer of securities received in the same way as the gain arising on the transfer of securities existing before the acquisition, nor from taking into account when taxing shareholders any cash payment that may be made on the merger, division, partial division or exchange of shares.⁴⁶⁷

The pending *Marc Lassus* case (Case C-421/16) raises the question of whether a Member State is allowed to fix the amount of tax due on a capital gain at the time of the restructuring operation and collect the proportionate amount of tax when the shareholder subsequently sells the shares received. Arguably, this would seem to be a deviation from the carryover mechanism under the Merger Tax Directive whereby a taxpayer carries over the balance-sheet values of the shareholding and a Member State ultimately taxes that taxpayer on the difference between the real value and the balance-sheet value of the shareholding (if positive).

c. Special Case of Transfer of Permanent Establishment

Where the assets transferred in a merger, division, partial division or transfer of assets include a PE of the transferring company that is situated in a Member State other than that of the transferring company, the Member State of the transferring company must renounce any right to tax that PE, but may re-instate in the taxable profits of that company such losses of the PE as may previously have been set off against the taxable profits of the company in that Member State that have not been recovered. The Member State in which the PE is situated and the Member State of the receiving company are to apply the provisions of the Directive to such a transfer as if the Member State in which the PE is situated were the Member State of the transferring company. The same applies where the PE is situated in the same Member State as that in which the receiving company is resident.⁴⁶⁸

By way of derogation, where the Member State of the transferring company applies a system of taxing worldwide profits, that Member State has the right to tax any profits or capital gains of the PE resulting from the merger, division, partial division or transfer of assets, on condition that it gives relief for the tax that, but for the provisions of the Directive, would have been charged on those profits or capital gains in the Member State in which that PE is situated, in the same way and in the same amount as it would have done if that tax had actually been charged and paid.⁴⁶⁹

⁴⁵⁹ Merger Tax Directive, Art. 5.

⁴⁶⁰ Merger Tax Directive, Art. 6.

⁴⁶¹ Merger Tax Directive, Art. 7.

⁴⁶² Case C-207/11, 3D I.

⁴⁶³ Merger Tax Directive, Art. 8(1).

⁴⁶⁴ Merger Tax Directive, Art. 8(2).

⁴⁶⁵ Merger Tax Directive, Art. 8(3).

⁴⁶⁶ Merger Tax Directive, Art. 8(4) and (5).

⁴⁶⁷ Merger Tax Directive, Art. 8(6) and (9).

⁴⁶⁸ Merger Tax Directive, Art. 10(1).

⁴⁶⁹ Merger Tax Directive, Art. 10(2). The freedom of establishment precludes a national (exit tax) provision (intended to implement Merger Tax Di-

d. Special Case of Transparent Entities

Where a Member State considers a nonresident *transferring* or *acquired* company to be fiscally transparent based on that Member State's assessment of the legal characteristics of that company arising from the law under which it is constituted, it has the right not to apply the provisions of the Merger Tax Directive when taxing a direct or indirect shareholder of that company with respect to the income, profits or capital gains of the company.⁴⁷⁰ However, a Member State exercising this right must give relief for the tax that, but for the provisions of this Directive, would have been charged on the fiscally transparent company on its income, profits or capital gains, in the same way and in the same amount as that Member State would have done if that tax had actually been charged and paid.⁴⁷¹

Where a Member State considers a nonresident *receiving* or *acquiring* company to be fiscally transparent based on that Member State's assessment of the legal characteristics of that company arising from the law under which it is constituted, it has the right not to exonerate the allotment of securities representing the capital of that company to a shareholder of the transferring company or acquired in exchange for securities representing the capital of the latter company.⁴⁷² If a Member State considers a nonresident *receiving* company to be so fiscally transparent, it may apply to any direct or indirect shareholders the same treatment for tax purposes as it would if the receiving company were resident in that Member State.⁴⁷³

2. Rules Applicable to the Transfer of the Registered Office of a European Company or a European Cooperative Society

Where:

(i) An SE or an SCE transfers its registered office from one Member State to another Member State; or

(ii) In connection with the transfer of its registered office from one Member State to another Member State, an SE or an SCE that is resident in the first Member State ceases to be resident in that Member State and becomes resident in another Member State, the transfer of registered office or cessation of residence does not give rise to any taxation, in the Member State from which the registered office is transferred, of capital gains derived from those assets and liabilities of the SE or SCE that, in consequence, remain effectively connected with a PE of the SE or SCE in the Member State from which the registered office is transferred and play a part in generating the profits or losses of the PE taken into account for tax purposes.⁴⁷⁴

This rule applies only if the SE or SCE computes any new depreciation and any gains or losses with respect to the assets

and liabilities that remain effectively connected with that PE as though the transfer of the registered office had not taken place or the SE or SCE had not so ceased to be tax resident.⁴⁷⁵ If, under the laws of the Member State from which the registered office is transferred, the SE or SCE is entitled to have any new depreciation or any gains or losses with respect to the assets and liabilities remaining in that Member State computed on a different basis, the "tax neutrality" regime will not apply to the assets and liabilities with respect to which that option is exercised.⁴⁷⁶

Provisions or reserves properly constituted by the SE or SCE before the transfer of the registered office that are partly or wholly exempt from tax and are not derived from PEs abroad may be carried over, with the same tax exemption, by a PE of the SE or SCE situated in the territory of the Member State from which the registered office is transferred.⁴⁷⁷

To the extent a company transferring its registered office in the territory of a Member State would be allowed to carry-forward or carryback losses that had not been exhausted for tax purposes, that Member State must allow the PE, situated in its territory, of the SE or SCE transferring its registered office to take over the losses of the SE or SCE that have not been exhausted for tax purposes, provided the loss carryforward or carryback would have been available in comparable circumstances to a company that continued to have its registered office, or continued to be tax-resident, in that Member State.⁴⁷⁸

The transfer of the registered office of an SE or SCE does not, of itself, give rise to any taxation of the income, profits or capital gains of the shareholders.⁴⁷⁹ However, this does not prevent the Member States from taxing the gain arising on a subsequent transfer of the securities representing the capital of the SE or SCE that transfers its registered office.⁴⁸⁰

D. Anti-Abuse Rule

A Member State may refuse to apply or may withdraw the benefit of all or any part of the tax deferral regime established by the Merger Tax Directive where it appears that one of the operations covered by the Directive 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 rationalization 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.⁴⁸¹

rective, Art. 10(2)) that imposes immediate taxation in the Member State of the transferring company where the PE transferred and the receiving company are situated in another Member State, whereas such taxation does not apply in a similar domestic case (Case C-292/16, A); *see also*, Case C-371/10, *National Grid*. See II.E.4.f., above, on exit taxes.

⁴⁷⁰ Merger Tax Directive, Art. 11(1).

⁴⁷¹ Merger Tax Directive, Art. 11(2).

⁴⁷² Merger Tax Directive, Art. 11(3).

⁴⁷³ Merger Tax Directive, Art. 11(4).

⁴⁷⁴ Merger Tax Directive, Art. 12(1).

⁴⁷⁵ Merger Tax Directive, Art. 12(2).

⁴⁷⁶ Merger Tax Directive, Art. 12(3).

⁴⁷⁷ Merger Tax Directive, Art. 13(1).

⁴⁷⁸ Merger Tax Directive, Art. 13(2).

⁴⁷⁹ Merger Tax Directive, Art. 14(1).

⁴⁸⁰ Merger Tax Directive, Art. 14(2).

⁴⁸¹ Merger Tax Directive, Art. 15(1)(a). Art. 15(1)(b) authorizes Member States to refuse to apply or withdraw the benefit of the Directive where it appears that one of the operations 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 that were in force prior to that operation; this provision will apply as long as, and to the extent that, no EU law provisions containing equivalent rules on the representation of employees on company organs are applicable to the companies covered by the Directive.

In *Leur-Bloem*,⁴⁸² the seminal case on the interpretation and construction of this anti-abuse provision, the CJEU held that the Member States must grant the tax advantages provided for by the Directive with respect to the operations covered by it, unless those operations have as their principal objective, or as one of their principal objectives, tax evasion or tax avoidance. In this regard, the Member States may stipulate that the fact that those operations were not carried out for valid commercial reasons — which is a concept involving more than the attainment of a purely fiscal advantage — constitutes a presumption of tax evasion or tax avoidance. It is for the Member States, observing the principle of proportionality, to determine the internal procedures necessary for this purpose. However, to determine whether the planned operation has an objective of tax evasion or tax avoidance, the competent national authorities cannot confine themselves to applying predetermined general criteria but must subject each particular case to a general examination. Such an examination must, moreover, be open to judicial review.

The examination may look at various factors (for example, the acquiring company not itself carrying on a business, the identity of the shareholder(s) and director(s) being the same before and after the operation, the involvement of a newly-created holding company, the restructuring of companies that already form a single entity from an economic and financial point of view, and the creation of a specific structure for a limited period of time and not on a permanent basis), but none of those factors may be considered to be decisive on its own. On the other hand, the laying down of a general rule automatically excluding certain categories of operations from the tax advantage, whether or not there is actually tax evasion or tax avoidance, would go further than is necessary for preventing tax evasion or tax avoidance and would undermine the aim pursued by the Directive. This would also be the case if a rule of this kind were to be made subject to the mere possibility of the grant of a derogation, at the discretion of the administrative authority.

*Kofoed*⁴⁸³ further elaborates on this case law by specifying that the anti-abuse provision in the Merger Tax Directive reflects the general EU law principle that abuse of EU law (or abuse of rights) is prohibited, thus suggesting that it must be interpreted in line with the contents and structural elements of that principle, as expressed in (*inter alia*) *Halifax*⁴⁸⁴ and *Cadbury Schweppes*.⁴⁸⁵

In *Foggia*,⁴⁸⁶ the CJEU repeated that the concept of “valid economic reasons” involves more than the attainment of a purely fiscal advantage. Consequently, a merger operation based on a number of objectives, which may also include tax considerations, can constitute a valid commercial reason provided, however, that those considerations are not predominant in the context of the proposed transaction. Accordingly, where the merger operation has the sole aim of obtaining a tax advantage and is not carried out for valid commercial reasons, such a finding may constitute a presumption that the operation has tax evasion or avoidance as one of its principal objectives. The fact that, in

the case of a merger operation between two companies of the same group, on the date of the merger operation, the acquired company does not carry out any activity, does not have any financial holdings and transfers to the acquiring company only substantial tax losses, even though that operation has a positive effect in terms of cost structure savings for that group (albeit marginal ones) may constitute a presumption that the operation has not been carried out for “valid commercial reasons.”

*Euro Park Service*⁴⁸⁷ concerned a French tax rule under which a cross-border merger cannot benefit from tax neutrality (as a domestic merger would) unless the French tax authorities deliver prior approval (*agrément préalable*) subject to certain conditions, i.e., prior approval is to be granted where, having regard to the assets transferred:

- (i) The operation is justified for commercial reasons, resulting, *inter alia*, in the exercise by the company receiving the transfer of an independent activity, in the improvement of structures or in an association between the parties;
- (ii) The operation does not have as its principal objective or as one of its principal objectives tax evasion or tax avoidance; and
- (iii) The manner in which the operation is carried out makes it possible for the capital gains deferred for tax purposes to be taxed in the future.

The prior approval procedure was introduced into French tax law as a way to implement Article 11 of Directive 90/434 (now: Article 15 of the Merger Tax Directive). According to the CJEU, Article 11(1)(a) of Directive 90/434 (now: Article 15(1)(a) of the Merger Tax Directive) authorizes Member States not to apply the provisions of Directive 90/434 on only one condition, namely that the operation covered by that directive “has as its principal objective or as one of its principal objectives tax evasion or tax avoidance.” In requiring the above conditions (i) and (ii) to be fulfilled, the French legislature derived two conditions from the single element laid down in Article 11(1)(a) and, therefore, extended the scope of the reservation of competence beyond that laid down in that provision. Moreover, condition (iii), which is also not provided for in Article 11(1)(a), cannot be justified by the aim of combating tax evasion or tax avoidance, since that objective is already expressly covered by condition (ii).

This is substantially different from the position in *Pelati*,⁴⁸⁸ which also concerned the existence of a prior administrative procedure designed to assess eligibility for the advantages set out in Directive 90/434, where the CJEU ruled that legislation such as that at issue “under which the grant of the tax advantages applicable to a division in accordance with that directive is subject to the condition that the application relating to that operation is submitted within a specified period” was not contrary to Directive 90/434 and left it to the referring court to ascertain whether the details, and more particularly the starting-point, of the time-limit for submitting the pending application complied with the principle of effectiveness. However, *Pelati* did not concern the substantive conditions for obtaining prior approval (as is the case in *Euro Park Service*).

⁴⁸² Case C-28/95, *Leur-Bloem*.

⁴⁸³ Case C-321/05, *Kofoed*.

⁴⁸⁴ Case C-255/02, *Halifax*.

⁴⁸⁵ Case C-196/04, *Cadbury Schweppes*.

⁴⁸⁶ Case C-126/10, *Foggia*.

⁴⁸⁷ Case C-14/16, *Euro Park Service*. See also, II.G.2.b., above.

⁴⁸⁸ Case C-603/10, *Pelati*.

In addition, in *Euro Park Service*, it was held that the process of prior approval, by systematically and unconditionally requiring that evidence be provided that the operation at issue is justified for commercial reasons and does not have as its principal objective or as one of its principle objectives tax evasion or tax avoidance, without the tax authority being required to provide even *prima facie* evidence of the absence of valid commercial reasons or evidence of tax evasion or tax avoidance, constitutes in essence a general presumption of tax evasion or tax avoidance. The introduction of such a presumption subjects, systematically and in advance, every cross-border merger to significant administrative constraints, even where there is no evidence whatsoever of tax evasion or tax avoidance. Such a presumption therefore goes against the objective of Directive 90/434, which, according to its first recital, seeks to reduce obstacles to mergers, divisions, transfers of assets and exchanges of shares involving companies of different Member States arising from the tax provisions of those Member States. This is in line with *Foggia*,⁴⁸⁹ in which the CJEU held that, to determine whether the operation concerned pursues the objective of tax evasion or avoidance, the competent national authorities may not confine themselves to applying predetermined general criteria but must subject each particular case to a general examination of that operation, since the imposition of a general rule automatically excluding certain categories of operations from the tax advantage, without account being taken of whether there is actually tax evasion or avoidance, would go further than is necessary for preventing such tax evasion or avoidance and would undermine the objective pursued by the directive.

⁴⁸⁹ Case C-126/10, *Foggia*.

CJEU case law has made two further clarifications in this area. First, as, according to settled case law, directives are unable by themselves to create obligations for individuals and cannot therefore be relied on *per se* by the Member State as against individuals,⁴⁹⁰ each of the Member States to which a directive is addressed is obliged to adopt, within the framework of its national legal system, all the measures necessary to ensure that the directive is fully effective, in accordance with the objective that it pursues.⁴⁹¹ It follows that if a Member State has not incorporated the Directive-based anti-abuse clause into its legal order, whether formally and specifically or by transposition achieved through a general legal context that does not go beyond the Directive-based anti-abuse rule as interpreted by the CJEU (so that a formal and express re-enactment of the provisions of the directive in specific national provisions is not necessary), that Member State cannot reduce the effect of the rest of the provisions of the Merger Tax Directive on that basis (and, hence, in such circumstances has to accord the benefits of the Directive).⁴⁹² Second, given that the Merger Tax Directive is designed to remove certain fiscal obstacles (in the field of income tax) to cross-border reorganizations, and given that the anti-abuse provision in the Directive is a provision setting out an exception that is thus subject to strict interpretation, “tax evasion or avoidance” is to be understood to mean only the avoidance or evasion of income tax and not the evasion or avoidance of other taxes (such as, in the case at hand, Dutch real property transfer tax).⁴⁹³

⁴⁹⁰ See, *inter alia*, Case 14/86 *Pretore di Salò*; Case 80/86 *Kolpinghuis Nijmegen*; Case C168/95 *Arcaro*; Joined Cases C-387/02, C391/02 and C403/02 *Berlusconi and Others*.

⁴⁹¹ See, *inter alia*, Case C-531/03 *Commission v. Germany*; Case C-456/03 *Commission v. Italy*.

⁴⁹² Case C-321/05, *Kofoed*.

⁴⁹³ Case C-352/08, *Zwijnenburg*.

IV. Parent-Subsidiary Directive

A. Introduction

Executive Summary

This Section gives an overview of the Parent-Subsidiary Directive. The purpose of the Parent-Subsidiary Directive is to: (i) eliminate withholding tax on dividends paid by a qualifying subsidiary in one Member State to a qualifying parent in another EU Member State; and (ii) to provide for either a partial or a full dividend-received exemption or a tax credit for taxes paid on dividends received by a qualifying parent in one Member State from a qualifying subsidiary in another EU Member State.

A *de minimis* (specific) anti-abuse rule, the scope of which has been further refined by the CJEU, was introduced in 2015.

On July 23, 1990, the Council adopted Council Directive 90/435/EEC on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States. As Directive 90/435/EEC had been substantially amended several times and further amendments needed to be made, it was recast by Council Directive 2011/96/EU of November 30, 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (the “Parent-Subsidiary Directive”).

There are two key elements of the Parent-Subsidiary Directive:

- (i) The elimination of withholding tax on dividends paid by a qualifying subsidiary to a qualifying parent; and
- (ii) The provision for either a partial or a full dividend-received exemption or a tax credit for taxes paid on dividends received by a qualifying parent from a qualifying subsidiary.

Effectively, this means that dividends distributed by a company in one Member State that holds a specified minimum percentage of the share capital of a company located in another Member State will be exempt from:

- (i) Withholding taxes in the source Member State; and
- (ii) All (or nearly all) corporate taxes on the dividends received in the recipient Member State.

These rules are extended to dividends received by a qualifying PE (see IV.B.1., below).

On November 25, 2013, the Commission proposed to amend the Parent-Subsidiary Directive (the “2013 Proposed Amendment”).⁴⁹⁴ The 2013 Proposed Amendment sought to:

- (i) Tackle hybrid financial mismatches within the scope of application of the Parent-Subsidiary Directive; and

- (ii) Introduce a common general anti-abuse rule (GAAR) to protect the functioning of the Directive.

Following the reaching of a political agreement at the Council’s meeting of June 20, 2014, the 2013 Proposed Amendment was split to allow early adoption of the new rule on hybrid loans, while enabling work on the introduction of a common anti-abuse provision to continue.

On July 8, 2014, the Council formally adopted the “hybrid instruments” limb of the 2013 Proposed Amendment.⁴⁹⁵ On January 27, 2015, the Council addressed the second limb of the 2013 Proposed Amendment by introducing a binding anti-abuse clause as a *de minimis* rule (allowing Member States to apply stricter national rules) in the Parent-Subsidiary Directive.⁴⁹⁶

B. Scope

1. Material Scope

The Parent-Subsidiary Directive applies to distributions of profits:

- (i) Received by a company in one Member State from a subsidiary in another Member State;
- (ii) Made by a company in one Member State to a company in another Member State of which the first company is a subsidiary;
- (iii) Received by a PE situated in a Member State of a company in another Member State from its subsidiary in a Member State other than that in which the PE is situated; or
- (iv) Made by a company in a Member State (A) to a PE situated in another Member State (B) of a company of the same Member State (i.e., A) of which the first company is a subsidiary.⁴⁹⁷

The precise meaning of the expression “distributions of profits” is unclear. However, because reference is made to “distributions of *profits*” rather than “distributions of *dividends*,” it is generally argued that the concept covers all transfers of economic benefits from a qualifying subsidiary to a qualifying parent company by virtue of the association between the companies, including dividends *stricto sensu* and all equivalent forms of making the profits of a subsidiary available to its parent company. As such, the concept should cover not only open dividend distributions but also “constructive” distributions, i.e., deemed distributions for tax purposes. However, the treatment of the latter remains the subject of debate.

Support for the “broad” interpretation may be found in:

- (i) The reference in Article 4(1) of the Parent-Subsidiary Directive to distributed profits “except when the subsidiary is liquidated” (see IV.C., below), seemingly im-

⁴⁹⁴ Proposal for a Council Directive amending Directive 2011/96/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, COM (2013) 814 final.

⁴⁹⁵ Council Directive 2014/86/EU of July 8, 2014 amending Directive 2011/96/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States.

⁴⁹⁶ Council Directive (EU) 2015/121 of January 27, 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.

⁴⁹⁷ Parent-Subsidiary Directive, Art. 1(1).

plying that all distributions of profits other than distributions made in the context of the liquidation of a subsidiary amount to “distributions of profits” within the meaning of the Directive; and

(ii) Article 4(2) of the Interest-Royalty Directive (see V., below), which excludes from the concepts of “interest” and “royalties” the portion of any such payment made between associated parties in excess of the arm’s length price, thus suggesting that the excess amount may be treated as a dividend.⁴⁹⁸

According to the CJEU, fictitious or deemed interest established by the tax authorities cannot be regarded as a “distribution of profits” within the meaning of the Parent-Subsidiary Directive.⁴⁹⁹ The relevant ruling concerned a case in which the (Bulgarian) tax authorities claimed, based on a domestic anti-abuse provision, that fictitious or deemed interest — on which a 10% withholding tax was due — should be imputed in the context of a convertible interest-free loan granted by a Luxembourg-based parent company to its Bulgarian subsidiary. After rejecting the application of the Parent-Subsidiary Directive (as well as the application of the Interest and Royalty Directive and the Capital Duty Directive), the CJEU decided the case based on Article 63 of the TFEU.⁵⁰⁰

2. Personal Scope — Minimum Holding and Minimum Holding Period Requirements

For the purposes of the Parent-Subsidiary Directive, a “company of a Member State” is any company that:

- (i) Takes one of the forms listed in Annex I, Part A (an exhaustive list);⁵⁰¹
- (ii) Under the laws of a Member State is considered to be tax resident in that Member State and, under the terms of a double taxation agreement concluded with a third State, is not considered to be tax resident outside the European Union; and
- (iii) Is subject to one of the taxes listed in Annex I, Part B, without the possibility of an option to be, or the possibility of being, exempt, or to any other tax that may be substituted for any of those taxes.⁵⁰²

The “subject to tax” test lays down the following qualifying criteria:

- (i) A positive criterion, i.e., the necessity of being subject to the tax in question; and
- (ii) A negative criterion, i.e., the necessity of not being exempt from that tax and not having the possibility of an option to be so exempt.

⁴⁹⁸ Compare OECD Model Tax Convention, Arts. 11(6) and 12(4).

⁴⁹⁹ Case C-257/20, *Viva Telecom Bulgaria*.

⁵⁰⁰ See the discussion at II.E.6.f., above.

⁵⁰¹ Case C-247/08, *Gaz de France*. See, however, Case C-48/11, *A Oy*, where the CJEU decided that, subject to certain conditions, the benefits under the Merger Tax Directive should be expansively applied beyond the scope of that Directive for the sake of the fundamental freedoms, i.e., the freedom of establishment under the EEA Agreement requires tax neutral treatment of exchanges of shares between EU and EEA companies. SE/SCEs come within the scope of the Directive.

⁵⁰² Parent-Subsidiary Directive, Art. 2(a).

The existence of these two criteria, one positive, the other negative, leads to the conclusion that the “subject to tax” condition does not merely require that a company should fall within the scope of the tax in question. It also seeks to exclude situations involving the possibility that, despite being subject to that tax, the company is not actually liable to pay it. Thus, although a company subject to a tax at a zero rate on the condition that all of its profits are paid to its shareholders is formally not exempt from that tax, it is, in practical terms, in a situation in which it is not liable to pay the tax.⁵⁰³ In other words, the inclusion in national legislation of a provision whereby a specific category of companies may, in certain circumstances, be entitled to be taxed at a zero rate is tantamount to not subjecting those companies to that tax.⁵⁰⁴

A “permanent establishment” means a fixed place of business situated in a Member State through which the business of a company of another Member State is wholly or partly carried on insofar as the profits of that place of business are subject to tax in the Member State in which it is situated under the relevant tax treaty or, in the absence of such a treaty, under national law.⁵⁰⁵

The status of “parent company” belongs to:

- (i) A company that qualifies as a “company of a Member State” and has a minimum holding of 10% in the capital of a company of another Member State that fulfills the same conditions; and
- (ii) Subject to the same conditions, a company of a Member State that has a minimum holding of 10% in the capital of a company of the same Member State, held in whole or in part by a PE of the former company situated in another Member State.⁵⁰⁶

Conversely, “subsidiary” means a company whose capital includes the holding referred to above.⁵⁰⁷ According to the CJEU, it is not possible to interpret the concept of a holding in the capital of a company of another Member State as covering the holding, in usufruct, of shares in the capital of a company of another Member State. This is because a usufruct holder only has a right to distributed profits. The profits placed in reserve revert to the legal owner. Thus, where profits are distributed, neither the usufruct holder nor the legal owner is able to enjoy a double taxation advantage. In other words, the EU legislature regards the concept of “parent company,” within the meaning of the Parent-Subsidiary Directive, as referring to a single company.⁵⁰⁸

To avoid conflicts between the Parent-Subsidiary Directive and tax treaties concluded by Anglo-Saxon Member States, most of which employ the concept of “a holding of voting rights” rather than “a holding in the capital,” Member States have the option of replacing, by means of bilateral agreements,

⁵⁰³ Case C-448/15, *Wereldhave and Others*.

⁵⁰⁴ See also, Case C-194/06, *Orange European Smallcap Fund*, C-194/06.

⁵⁰⁵ Parent-Subsidiary Directive, Art. 2(b).

⁵⁰⁶ Parent-Subsidiary Directive, Art. 3(1)(a).

⁵⁰⁷ Parent-Subsidiary Directive, Art. 3(1)(b).

⁵⁰⁸ Case C-48/07, *Les Vergers du Vieux Tauves* (referring, by way of analogy, to Case C-220/03, *BCE v. Germany* and Case C-263/06, *Carboni e derivati*).

the holding of capital criterion with a holding of voting rights criterion.⁵⁰⁹

In addition, Member States have the option of not applying the Directive to:

- (i) Companies of a Member State that do not maintain, for an uninterrupted period of at least two years, holdings qualifying them as parent companies; or
- (ii) Domestic companies in which a company of another Member State does not maintain such a holding for an uninterrupted period of at least two years.⁵¹⁰

The purpose of this provision is to prevent abusive coupon stripping. Many of the Member States have taken advantage of this option, some enacting one-year holding periods, even though the Directive itself speaks of “at least two years” rather than “up to two years.” A number of Member States have interpreted this option as requiring the holding period requirement to be met at the time of the profit distribution. However, the CJEU has rejected this interpretation.⁵¹¹ Although Member States are not required to grant withholding relief immediately from the beginning of the holding period, they may not refuse to apply the Directive even if the holding period has not yet fully elapsed at the time of the profit distribution. It is up to the Member States to ensure compliance with their respective minimum holding periods in a reasonable fashion (for example, by requiring a guarantee or deposit). As a result of the CJEU’s ruling, many Member States have amended their legislation.

Unlike the Interest and Royalty Directive (see V., below), the Parent-Subsidiary Directive does not provide for a “beneficial ownership” requirement. In the Danish “beneficial ownership” cases,⁵¹² the CJEU ruled that this did not prevent Member States from denying the benefits of the Parent-Subsidiary Directive in instances where there was an abuse of rights. The legal basis for this is the general legal principle that EU law cannot be relied on for abusive or fraudulent ends. This is the case, for example, where the underlying transaction is purely artificial in economic terms and is designed to circumvent the application of the legislation of the Member State concerned. For a discussion of the proof required to demonstrate the existence of an abusive practice, see XXIII.B., below.

C. Elimination of Double Taxation at the Parent Company Level

1. Exemption Versus Credit Method

a. General

Where a parent company or its permanent establishment (PE), by virtue of the association of the parent company with a subsidiary, receives distributed profits, the Member State of

the parent company and the Member State of its PE are obliged, except when the subsidiary is liquidated, either to:

- (i) Refrain from taxing such profits; or
- (ii) Tax such profits but authorize the parent company and the PE to deduct from the amount of tax due the fraction of the corporation tax related to those profits and paid by the subsidiary and any lower-tier subsidiary (provided that, at each tier, a company and its lower-tier subsidiary qualify under the conditions and requirements of the Directive) up to the limit of the amount of the corresponding tax due.⁵¹³

b. Hybrid Financial Instrument Mismatches

Further to the 2013 Proposed Amendment, as formally adopted by the Council on July 8, 2014 (see, IV.A., above), the Member State of the receiving company (i.e., the parent company or its PE) is to refrain from taxing the profit distribution received only to the extent the profit distribution is not deductible in the source Member State (i.e., in the Member State of the distributing subsidiary).

The Member State of the receiving company is therefore to tax the portion of profits that is deductible in the source Member State. The rationale for the amendment is the perceived distortion in the competition between cross-border and domestic groups, which is contrary to the intent of the Parent-Subsidiary Directive, due to the increase in cross-border investments that give cross-border groups the opportunity to use hybrid financial instruments.

Hybrid financial instruments treated differently for tax purposes in the State of the issuer and that of the holder typically involve cross-border profit-participating loans or convertible preference shares that produce deductions for the issuer without matching taxable receipts for the holder. This results in advantages from:

- (i) Mismatches between different national tax treatments; and
- (ii) The standard international rules for the relief of double taxation.

The amendment is relevant only to jurisdictions that have chosen to provide an exemption for distributions. The “credit” option remains unchanged (this may be because credit regimes are less susceptible to exploitation by hybrid instruments as the effect of the deduction in the issuer’s jurisdiction will generally be to reduce the credit available in the holder’s jurisdiction).

If and to the extent a hybrid financial instrument mismatch is already neutralized under the Parent-Subsidiary Directive (i.e., a payment that qualifies as interest and is deductible in the hands of the payer will not be exempt in the hands of the payee if it qualifies as a dividend under the tax law of the payee’s Member State), the ATAD 1 and 2 hybrid financial instrument mismatch provisions (see VI.B.6., below) should not come into play, the reason being that, as *lex specialis*, the Parent-Subsidiary Directive prevails.

⁵⁰⁹ Parent-Subsidiary Directive, Art. 3(2)(a).

⁵¹⁰ Parent-Subsidiary Directive, Art. 3(2)(b).

⁵¹¹ Joined Cases C-283/94, C-291/94 and C-292/94, *Denkavit International*.

⁵¹² Joined Cases 116/16, *T Denmark* and 117/16, *Y Denmark*. These judgments should be seen in close conjunction with the CJEU’s decisions rendered in Joined Cases C-115/16, *N Luxembourg 1*, C-118/16, *X Denmark*, C-119/16, *C Denmark I* and C-299/16, *Z Denmark*, which concerned the application of the Interest and Royalty Directive, all such cases commonly referred to as the “Danish Beneficial Ownership” cases (see the discussion E., below).

⁵¹³ Parent-Subsidiary Directive, Art. 4(1).

c. “Elimination of Double Taxation”

The CJEU has had several opportunities to clarify the scope and meaning of the “elimination of double taxation” provision.

*Cobelfret*⁵¹⁴ concerned the Belgian dividends-received deduction (an application of the exemption method), which, at the time, only allowed a parent company to benefit from a full exemption if it had neither realized any losses nor borne deductible costs exceeding 5% of the dividend received in the same tax period. The CJEU decided that the system was not compatible with the terms and objectives of the Parent-Subsidiary Directive. Specifically, the CJEU held that the Parent-Subsidiary Directive precluded legislation of a Member State that provided that dividends received by a parent company had to be included in its basis of assessment in order subsequently to be deducted from that basis in the amount of 95%, to the extent that, for the tax period in question, the parent company had a positive profit balance after the deduction of other exempted profits.⁵¹⁵

The CJEU further articulated the implications of this case law by specifying that a Member State is not necessarily obliged to permit profits distributed to a parent company established in that State by its subsidiary established in another Member State to be deducted in full from the parent company’s profits in the taxable period and allow any resulting loss to be carried forward to a later taxable period. However, as clarified in joined cases *KBC Bank* and *Beleggen, Risicokapitaal, Beheer*,⁵¹⁶ if a Member State has chosen the exemption system and, in principle, the legislation of that Member State allows losses to be carried forward to subsequent taxable periods, that Member State may not reduce the losses of the parent company that may be carried forward to the amount of the dividends received.

In *Brussels Securities*,⁵¹⁷ the CJEU held that the way in which Belgium implemented the exemption method (i.e., by first including dividends in the tax base, then providing for a deduction of such dividends) was not *per se* incompatible with the Parent-Subsidiary Directive, but the end result had to be a real exemption as a company could not be “taxed more heavily than would have been the case if it had not received dividends

from its nonresident subsidiary or if the dividends had simply been excluded from the parent company’s tax base.”

By analogy, *John Cockerill SA*⁵¹⁸ concerned the interaction of the Belgian dividends received deduction and the Belgian group contribution rules.⁵¹⁹ The CJEU decided that rules that included dividends received by a parent company in its tax base before subsequent deduction — without also allowing corresponding deduction of the group contribution included in the tax base — are contrary to Article 1(4) and Article 4(1) of Parent-Subsidiary Directive. Under the Belgian dividends received deduction, dividends must first be included in the tax base before they can subsequently be deducted, meaning that the receipt of (exempted) dividends may turn a negative tax base into a positive tax base. On the other hand, under the applicable legislation, the group contribution cannot be offset against dividends received. Including dividends received in the tax base may therefore result in a parent company that receives both dividends and a group contribution being taxed more heavily than if such dividends had been (upfront) excluded from its tax base. By first including dividends received in the tax base, current-year losses are wholly or partially washed out and, to that extent, the losses cannot be used to set off the group contribution, therefore the parent company is effectively indirectly taxed on the dividends received. In such a situation, the dividends received are not fiscally neutral for the parent company, which is contrary to the objective pursued by Article 4(1)(a) of Parent-Subsidiary Directive.

In *Banco Mediolanum*,⁵²⁰ Advocate-General Kokott held that the taxation of the received dividends by the Member State of the parent company by means of an additional tax, in so far as that tax is to be regarded as either a corporation tax or another tax that substitutes for or supplements any of those taxes, is also precluded by Article 4 of the Parent-Subsidiary Directive. Neither the timing of collection (inflow or outflow of dividends), nor the name of such a tax (instead of a corporation tax) is relevant for the purposes of assessing whether that tax in substance substitutes for corporation tax. Such assessment can only depend on the object of taxation and the legal nature or character of the tax at issue. The decisive factor is therefore the comparability of the tax at issue with the corporation tax under review. The determination of comparability is a question of national law. The ultimate classification of the tax at issue, as to its comparability with the relevant Member State’s corporation tax, is therefore a matter for the referring court.

d. “Except When the Subsidiary Is Liquidated”

As regards the “except when the subsidiary is liquidated” exclusion, the CJEU has noted that, as the concept of “liquidation” is not defined in the Parent-Subsidiary Directive, recourse

⁵¹⁴ Case C-138/07, *Cobelfret*. The Court added that it was not appropriate in the case at issue to limit the effects of its judgment in time as, according to settled case law, it is only exceptionally that the Court may, in application of the general principle of legal certainty inherent in the Community legal order, be moved to restrict for any person concerned the opportunity of relying on a provision that it has interpreted with a view to calling into question legal relationships established in good faith. Two essential criteria must be satisfied before such a limitation can be imposed, namely that those concerned should have acted in good faith and that there should be a risk of serious difficulty (see Case C-313/05 *Brzeziński*).

⁵¹⁵ See also, Case C-389/18, *Brussels Securities*, where the CJEU held that the way in which Belgium implements the exemption method (i.e., first including dividends in the tax base, then providing for a deduction of such dividends) is not *per se* incompatible with the Parent-Subsidiary Directive, but the end result must be a real exemption as a company cannot be “taxed more heavily than would have been the case if it had not received dividends from its nonresident subsidiary or if the dividends had simply been excluded from the parent company’s tax base.”

⁵¹⁶ Joined Cases C-439/07, *KBC Bank* and C-499/07, *Beleggen, Risicokapitaal, Beheer* (Order of the Court).

⁵¹⁷ Case C-389/18, *Brussels Securities*.

⁵¹⁸ Case C-135/24, *John Cockerill SA*.

⁵¹⁹ The Belgian group contribution rules provide for a system of “limited” tax consolidation under which qualifying group members continue to have their own tax base but are authorized to benefit from the tax losses of other qualifying group members. Under the regime, a member of a consolidation is eligible to deduct a group contribution from its taxable reserved profit, the group contribution then being taxable in the hands of the receiving company in the same taxable period.

⁵²⁰ Joined Cases C-92/24 to 94/24, *Banco Mediolanum*. A similar reasoning was followed by the CJEU in Case C-68/15, *X* regarding the Belgian fairness tax (see the discussion at C.3., below).

is to be had to the meaning of that concept under the Merger Directive.

At issue in the case concerned was a merger surplus realized by the acquiring company on a (“silent”) merger by acquisition within the meaning of the Belgian Companies Code, in which the absorbed companies were dissolved without going into liquidation and all their assets were transferred to the acquiring company. The acquiring company had insufficient taxable profits to apply the full 95% merger surplus deduction (compare the *Cobelfret* case discussed in IV.C.1.c., above).

While acknowledging that the definition of “merger” appeared in the Merger Directive and not in the Parent-Subsidiary Directive, the CJEU held that this did not prevent that definition from being taken into account for the purposes of the interpretation of the concept of “liquidation” within the meaning of the latter Directive.

According to the Court, it is important to note that:

- (i) The Commission submitted both Directive proposals on the same day;
- (ii) The Council adopted the two Directives on the same day; and
- (iii) The Directives were expected to be transposed simultaneously.

Furthermore, in material terms, both Directives have the same objective — to abolish restrictions, disadvantages or distortions arising, in particular, from the tax provisions of the Member States applicable to the operations covered by the Directives.

In the Court’s view, it follows that those Directives, which govern different types of transnational cooperation between companies, constitute a whole according to the plan of the EU legislature, in that they complement each other. Accordingly, the definition of the concept of “merger” in the Merger Directive is also relevant for the interpretation of the concept of “liquidation” within the meaning of the Parent-Subsidiary Directive. Thus, the dissolution of a company in the context of a merger by acquisition cannot be considered to be a “liquidation” within the meaning of the latter Directive. For this reason, the merger surplus at issue was found to come within the scope of the Parent-Subsidiary Directive.⁵²¹

2. Fiscally Transparent Treatment of Subsidiary

Nothing in the Parent-Subsidiary Directive prevents the Member State of the parent company from considering a subsidiary to be fiscally transparent based on that Member State’s assessment of the legal characteristics of the subsidiary arising from the law under which it is constituted and, therefore, from taxing the parent company on its share of the profits of the subsidiary as and when those profits arise. In such circumstances, the Member State of the parent company must refrain from taxing the distributed profits of the subsidiary. When assessing the parent company’s share of the profits of the subsidiary as they arise, the Member State of the parent company should either exempt those profits or authorize the parent company to deduct from the amount of tax due that fraction of the corporation tax related to the parent company’s share of profits and paid by its

qualifying subsidiary and any lower-tier qualifying subsidiary, up to the limit of the amount of the corresponding tax due.⁵²²

3. Charges Related to Holdings and Losses from Profit Distributions

Member States have the option of providing that any charges relating to the holding and any losses resulting from the distribution of the profits of a subsidiary may not be deducted from the taxable profits of the parent company.⁵²³

In *Bosal Holdings*,⁵²⁴ the CJEU considered a national provision that, in determining the tax on the profits of a parent company established in one Member State, made the deductibility of costs in connection with that company’s holding in the capital of a subsidiary established in another Member State subject to the condition that such costs were indirectly instrumental in making profits that were taxable in the Member State in which the parent company was established. The Court held the provision to be compatible with the option offered by the Parent-Subsidiary Directive of providing that any charges relating to such a holding may not be deducted from the taxable profits of the parent company. However, the CJEU held that a Member State might exercise its ability so to provide only in compliance with the fundamental freedoms of the TFEU, in particular, in the case concerned, the freedom of establishment. It is therefore in relation to that freedom that it is necessary to examine the question of whether the Directive authorizes a Member State only partially to allow the deductibility of costs in relation to holdings, as did the Dutch tax provision at issue.

*Argenta Spaarbank*⁵²⁵ concerned the Belgian interest payment deduction rule laid down in Article 198(10) of the 1992 Belgian Income Tax Code, as it existed before 2002. Under this rule, the deduction of interest payments was disallowed to the extent that, in the same tax year, the taxpayer had received exempt dividends on shares held for less than one year. The limitation applied regardless of whether the interest payments were in fact connected to the financing of the acquisition of the holdings that gave rise to the exempt dividend.

The CJEU held the Belgian rule not to be compliant with (now) Article 4(3) of the Parent-Subsidiary Directive. The Court’s reasoning was that Article 4(3) does not permit a domestic provision that excludes, generally and automatically, the tax deductibility, as business expenses or charges, of interest relating to loans taken out by a parent company up to an amount equal to the amount of dividends paid out by a holding of that parent company in the capital of a subsidiary, that already benefit from tax deductibility. This applies even if the payment of the interest does not relate to the financing of the acquisition of that holding. In fact, Article 4(3) (only) grants Member States the right to deny the deduction of costs “relating to the holding,” since the dividends deriving from the holding are exempt. However, it excludes the right of Member States to deny the deduction of interest incurred by the parent company that is not related to the holding in the subsidiary up to the amount of the dividends received.

⁵²² Parent-Subsidiary Directive, Art. 4(2).

⁵²³ Parent-Subsidiary Directive, Art. 4(3), first para.

⁵²⁴ Case C-168/01, *Bosal Holdings*. See also II.E.4.j., above.

⁵²⁵ Case C-39/16, *Argenta Spaarbank*.

⁵²¹ Case C-371/11, *Punch Graphics*.

The objective of Article 4(3) is to prevent the parent company benefitting from a double tax advantage (“double dipping”) arising from:

- (i) Profits that are tax-exempt under the first indent of Article 4(1)(a) of the Parent-Subsidiary Directive; and
- (ii) The tax reduction achieved by means of a deduction for charges relating to holding losses resulting from the distribution of such profits.

Where the management costs relating to the holding in such a case are fixed as a flat rate, that fixed rate may not exceed 5% of the profits distributed by the subsidiary.⁵²⁶ For this purpose, the concept of “profits distributed by the subsidiary” is to be interpreted as not precluding legislation of a Member State that includes in those profits tax credits that have been granted to offset a withholding tax levied on the parent company by the Member State of the subsidiary.⁵²⁷

In *X*,⁵²⁸ the CJEU concluded that the Belgian fairness tax⁵²⁹ was (partially) incompatible with Article 4 (more precisely, Article 4(3)) of the Parent-Subsidiary Directive) in that it could lead to a higher tax burden than that allowed under the Parent-Subsidiary Directive if a corporate taxpayer receiving a dividend redistributed the dividend in a later taxable period. This is because the dividend received is taxed again on redistribution as it is included in the tax base of the fairness tax. In other words, where the profits distributed to a resident parent company by a nonresident subsidiary are distributed by that parent company after the year in which they were received, the “fairness tax” has the consequence of subjecting those profits to taxation exceeding the 5% ceiling provided for in Article 4(3), and therefore results in double taxation of those profits. In *AFEP and Others*,⁵³⁰ the Court arrived at a similar conclusion with respect to the French “*contribution additionnelle*,”⁵³¹ essentially following the same reasoning.

The Court also reached a similar conclusion in joined Cases C-92/24 to C-94/24, *Banca Mediolanum*, which concerned the Italian regional tax on production activities (IRAP), which is typically levied on top of the Italian ordinary corporate income tax (IRES). The case reiterates that Article 4 of the PSD must be interpreted as precluding national legislation under which a Member State that has opted for the exemption system may levy tax on more than 5% of the amount of dividends received by a financial intermediary resident in that Member State that is a parent company within the meaning of the PSD from a subsidiary resident in another Member State. This includes the situation in which this is achieved by way of a tax that is not a tax on corporate income but that includes such dividends or a fraction of such dividends in its basis of assessment.

⁵²⁶ Parent-Subsidiary Directive, Art. 4(3), second para.

⁵²⁷ Case C-27/07, *Banque Fédérative du Crédit Mutuel*.

⁵²⁸ Case C-68/15, *X*.

⁵²⁹ The Belgian fairness tax was a separate assessment aiming at taxing distributed profits (dividends) that were not effectively subject to Belgian corporate income tax due to “erosion” of the corporate tax base by application of the notional interest deduction regime and/or the tax loss carryforward deduction available under Belgian corporate income tax law.

⁵³⁰ Case C-365/16, *AFEP and Others*.

⁵³¹ The French “*contribution additionnelle*” was a corporate income tax surcharge of 3% assessed on dividend distributions made by certain French corporate taxpayers.

D. Exemption from Withholding Tax at the Subsidiary Level

Profits that a subsidiary distributes to its parent company are exempt from withholding tax.⁵³² The prohibition on the levying of withholding tax is to be interpreted strictly.⁵³³ Likewise, the Member State of a parent company may not charge withholding tax on the profits that the company receives from a subsidiary.⁵³⁴

The term “withholding tax” as used in the Parent-Subsidiary Directive does not cover an advance payment or prepayment (*précompte*) of corporation tax to the Member State of the subsidiary made in connection with a distribution of profits by the subsidiary to its parent company.⁵³⁵

According to the CJEU, the term “withholding tax” is not limited to certain types of national taxation. Moreover, it cannot be inferred from the taxes listed in (what is currently) Annex I, Part B for the purposes of identifying those companies of Member States that are regarded as falling within the scope of the Directive, that other taxes having the same effect are permitted, particularly since the final part of Article 2(a) of the Directive refers expressly to “any other tax which may be substituted for any of those taxes.”⁵³⁶

In addition, there is a withholding tax, within the meaning of the Directive, where national legislation provides that, in the event of the distribution of profits by a subsidiary (a public limited company or an equivalent company) to its parent company, in determining the taxable profits of the subsidiary, its total net profits, including income that has been subject to special taxation entailing an extinction of tax liability and nontaxable income, must be reincorporated into the basic taxable amount, when income falling within those two categories would not be taxable based on the relevant national legislation if it were to remain with the subsidiary and not be distributed to the parent company.⁵³⁷

In contrast, a withholding tax *can* be levied on a tax credit connected to dividends (i.e., an imputation credit), but only to the extent that withholding tax can be credited at the level of the recipient.⁵³⁸ A refund of the adjustment surtax or compensatory tax related to a dividend imputation system may possibly not amount to a (prohibited) “withholding tax.”⁵³⁹

In a case that concerned a tax uplift calculated on dividends paid by a German subsidiary to its German parent that constituted a tax burden of the subsidiary rather than of the parent company, the CJEU repeated that any tax on income received in the State in which dividends are distributed is a withholding tax on distributed profits if three cumulative conditions are fulfilled:

- (i) The chargeable event for the purposes of the tax is the payment of dividends or any other income from shares;

⁵³² Parent-Subsidiary Directive, Art. 5.

⁵³³ Case C-283/94, *Denkavit International*.

⁵³⁴ Parent-Subsidiary Directive, Art. 6.

⁵³⁵ Parent-Subsidiary Directive, Art. 7(1).

⁵³⁶ Case C-375/98, *Epson Europe*.

⁵³⁷ Case C-294/99, *Athinaiki Zythopoiia*.

⁵³⁸ C-58/01, *Océ Van der Grinten*.

⁵³⁹ Joined Cases C-338/08, *Ferrero* and C-339/09, *General Beverage Europe*.

- (ii) The taxable amount is the income from such shares; and
- (iii) The taxable person is the holder of the shares.

Consequently, a provision of national law that provides, where profits are distributed by a subsidiary to its parent company, for the taxation of income and asset increases of the subsidiary that would not have been taxed if the profits had remained with the subsidiary and had not been distributed to the parent company, does not constitute a withholding tax as, in such a case, the third condition — i.e., the taxable person is the holder of the shares — is not fulfilled.⁵⁴⁰

In *X*,⁵⁴¹ the question was raised whether the Belgian fairness tax (see IV.C.3., above) amounted to a withholding tax within the meaning of Article 5 of the Parent-Subsidiary Directive. The fairness tax is payable by the distributing company, not by the recipient of a dividend distribution. Referring to its holding in *Burda*,⁵⁴² the CJEU found that it was precisely for this reason that the fairness tax could not be considered to amount to a withholding tax. The Court added, rather redundantly (as its basic position was that the fairness tax could not be considered a withholding tax in the first place), that Article 5 of the Parent-Subsidiary Directive had to be interpreted as not precluding tax legislation subjecting resident companies and PEs to a tax on the distribution of dividends that, as a result of the use of certain tax advantages provided for by the national tax system, were not included in their final taxable profits.⁵⁴³

Finally, the Directive does not affect the application of domestic or agreement-based provisions designed to eliminate or lessen the economic double taxation of dividends, in particular provisions relating to the payment of tax credits to recipients of dividends.⁵⁴⁴ Thus, a charge on dividends forming an integral part of a body of domestic or agreement-based provisions designed to eliminate or lessen the economic double taxation of dividends is admissible within the context of the Parent-Subsidiary Directive where:

- (i) It is related to the payment of a tax credit introduced to mitigate the economic double taxation of dividends paid by a subsidiary situated in one Member State to its parent situated in another Member State; and
- (ii) The rate of tax is not so high as to cancel out the benefit of the imputation tax credit provision, but rather adjusts that benefit.⁵⁴⁵

In the same vein, although a tax treaty pursues the objective of preventing double taxation in the area of taxes charged

on income and capital, a withholding tax could be regarded as within the scope of this exclusion only if:

- (i) The tax treaty contained provisions intended to eliminate or mitigate the economic double taxation of dividends; and
- (ii) The charging of the withholding tax was not such as to cancel out the effects of those provisions.⁵⁴⁶

E. Anti-Abuse Rule

Member States' existing domestic anti-abuse measures cover a wide variety of forms and targets and have been designed in a national context to address the specific concerns of Member States and features of their tax systems.

As such, in 2013, the Commission proposed to insert a common anti-abuse rule in the Parent-Subsidiary Directive. This was achieved by the adoption of Council Directive (EU) 2015/121 of January 27, 2015, introducing a binding anti-abuse clause as a *de minimis* rule (allowing Member States to apply stricter national rules).⁵⁴⁷ Under this rule, inserted as new Article 1(2), Member States are not to grant the benefits of the Parent-Subsidiary Directive in relation to an arrangement or a series of arrangements that, 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 the Directive, are not genuine having regard to all relevant facts and circumstances. An arrangement may comprise more than one step or part. An arrangement or a series of arrangements is regarded as not genuine to the extent it is not put into place for valid commercial reasons that reflect economic reality.

In *Nordcurrent group*,⁵⁴⁸ the CJEU specified that to determine whether an arrangement or a series of arrangements is genuine or not, the tax authorities of the Member States should carry out an objective analysis of all the relevant facts and circumstances. In a situation where an arrangement consists of several stages, all the relevant facts and circumstances must be taken into account to determine whether one or more stages are not genuine. According to the Court, there is nothing in the anti-abuse provision to suggest that the relevant facts and circumstances to be examined for that purpose are limited to the situation existing at the time of a specific stage of the arrangement, for example the time at which dividends are paid.

Accordingly, although it is open to the national authorities to take account of the facts at the time of a given stage in order to classify a subsidiary established in another Member State as a non-genuine arrangement, the situation at that time is not the only relevant one for the purposes of such analysis. As such, a national practice where only the facts at the date of the transaction were assessed would be inconsistent with the anti-abuse provision contained in Article 1(2) and (3); and due regard must be given to any preceding facts and stages also. For example, where a dividend is paid, to assess whether an arrangement can be considered non-genuine for these purposes the rel-

⁵⁴⁰ Case 284/06, *Burda*.

⁵⁴¹ Case C-68/15, *X*.

⁵⁴² Case C-284/06, *Burda* (see above).

⁵⁴³ In Case C-365/16, *AFEP and Others*, concerning the French "*contribution additionnelle*" (see IV.C.3., above), the withholding tax analysis was not conducted by the CJEU due to the wording of the preliminary question. While the Belgian fairness tax and the "*contribution additionnelle*" undoubtedly shared similar features, unlike the Belgian fairness tax, the French corporate income surcharge applied irrespective of the use of any tax deductions reducing the French corporate tax base. The question remains open whether this fundamental difference could have led the CJEU to classify the "*contribution additionnelle*" as a withholding tax within the meaning of Parent-Subsidiary Directive, Art. 5.

⁵⁴⁴ Parent-Subsidiary Directive, Art. 7(2).

⁵⁴⁵ C-58/01, *Océ Van der Grinten*.

⁵⁴⁶ Joined Cases C-338/08, *Ferrero* and C-339/09, *General Beverage Europe*.

⁵⁴⁷ Member States were to bring into force the laws, regulations and administrative provisions necessary to comply with this amendment, in principle, by December 31, 2015 at the latest.

⁵⁴⁸ Case C-228/24, *Nordcurrent group*.

evant facts must be considered not just at the time of the payment of the dividend, but also for instance at the time of the establishment of the subsidiary in that structure and any activity taking place between that establishment and the time of paying the dividend must also be considered to determine whether there are valid commercial reasons for this structure and transaction. In addition, where a parent company has received dividends from a subsidiary under an arrangement that is classified as a non-genuine arrangement, that classification alone is not sufficient to allow the conclusion to be reached that, in enjoying an exemption from corporation tax with respect to those dividends, the parent company obtained a tax advantage that defeats the object and purpose of the Parent-Subsidiary Directive.

In conclusion, in *Nordcurrent*, the CJEU provided the methodology for assessing the existence of abuse under the PSD by defining the two separate tests that are required for the purpose: the first test, which is objective, is to establish the existence of a non-genuine arrangement lacking valid economic reasons; and the second test, which is subjective, is to determine whether the main purpose or one of the main purposes of the arrangement is to obtain a tax advantage that defeats the objectives of the PSD.

As was the case under former Article 1(2), the Parent-Subsidiary Directive does not preclude the application of domestic or agreement-based provisions required for the prevention of tax evasion, tax fraud or abuse. This led certain Member States to include in their respective national legislation anti-abuse provisions designed to curtail the use of European-based holding companies intended to allow non-EU based groups to take advantage of the Directive and avoid withholding tax that would otherwise have been due had dividends been paid directly from one of the countries concerned to a non-EU based parent. Illustrative of this is *Eqiom and Enka*,⁵⁴⁹ which concerned a French tax rule stating that, in order to enjoy a withholding tax exemption in a situation where it was owned by a company in a third country, the beneficiary of a dividend distribution had to prove that the chain of participation did not have as a principal objective or one of its principal objectives taking advantage of the exemption. According to the CJEU, Article 1(2) and Article

49 of the TFEU⁵⁵⁰ must be interpreted as precluding a Member State rule that imposes on a nonresident company directly or indirectly controlled by persons resident in a non-member State the burden of proving, for the purposes of the granting of an exemption from withholding tax under Article 5 of the Parent-Subsidiary Directive, that the reasons for the structuring of the chain of interests are not tax-based, without the authorities being obliged to provide evidence sufficient to demonstrate that an arrangement is a wholly artificial arrangements that does not reflect economic reality and whose purpose is to obtain a tax advantage.

In the same vein, in joined cases *Deister Holding and Juhler Holding*,⁵⁵¹ the CJEU held the 2007 German anti-avoidance rule, section 50d paragraph 3 of the German Income Tax Act (applicable until 2011), to be incompatible with Article 1(2) and Article 49 of the TFEU,⁵⁵² since, in not requiring the tax authorities to provide *prima facie* evidence of the absence of economic reasons or the presence of fraud or abuse, it entailed a general presumption of fraud or abuse. The CJEU came to an analogous conclusion in *GS*,⁵⁵³ which concerned the 2012 successor version of the German anti-treaty shopping provision.

In the Danish “beneficial owner” cases, the CJEU held that in light of the general prohibition on abusive practices and the need to comply with it when EU law is implemented, the absence of domestic or agreement-based anti-abuse provisions did not affect the national authorities’ obligation to refuse to grant entitlement to rights provided for by the Parent-Subsidiary Directive where they were invoked for fraudulent or abusive ends. In other words, the general principle of EU law to the effect that EU law cannot be relied on for abusive or fraudulent ends must be interpreted as meaning that, where there is a fraudulent or abusive practice, the national authorities and courts are to refuse the exemption from withholding tax on profits distributed by a subsidiary to its parent company, even if there are no domestic or agreement-based provisions providing for such a refusal.⁵⁵⁴

⁵⁵⁰ See the discussion at II.G.2.c., above.

⁵⁵¹ Joined Cases C-504/16, *Deister Holding* and C-613/16, *Juhler Holding*.

⁵⁵² See the discussion at II.G.2.c., above.

⁵⁵³ Case C-440/17, *GS* (Order of the Court).

⁵⁵⁴ Joined Case C-116/16, *T Denmark* and C-117/16, *Y Denmark*. See also the discussion at V.B.2., below.

⁵⁴⁹ Case C-6/16, *Eqiom and Enka*.

V. Interest and Royalty Directive

A. General

Executive Summary

This Section discusses the Interest and Royalty Directive. The Interest and Royalty Directive is aimed at eliminating source country tax on qualifying EU cross-border interest and royalty payments, provided certain conditions are fulfilled. Special attention is given to the beneficial owner requirement, which, unlike the equivalent requirement in the Parent-Subsidiary Directive, is a mandatory condition for falling within the scope of the Interest and Royalty Directive (as is clearly illustrated in the “Danish beneficial owner cases”).

A recast of the Interest and Royalty Directive has been on the table since 2006, essentially as a reaction to the substantial development of financing methods and instruments. The adoption of the Pillar Two Directive may eventually accelerate the recast process.

Council Directive 2003/49/EC of June 3, 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States (the “Interest and Royalty Directive”) is designed to put EU cross-border interest and royalty payments on an equal footing with domestic payments by eliminating juridical double taxation and cash-flow disadvantages. It is of equal concern that such payments should not escape taxation altogether.

Under the Directive, both interest and royalty payments are exempt from any taxes imposed on such payments in the source country, whether by deduction at source or by assessment, provided:

- (i) The beneficial owner of the interest or royalties is a qualifying company of another Member State or a PE situated in another Member State belonging to an EU-based company; and
- (ii) The company that is the payer, or the company whose PE is the payer, is an associated company of the beneficial recipient/owner of the payment.⁵⁵⁵

The Directive provides for a refund procedure for those cases where tax has been withheld at source.

Taxing the beneficial owner in the Member State of residence (or, in the case of a PE, in the Member State where the PE is located), guarantees that such income is taxed in the same jurisdiction as that in which the related expenditure is deductible (i.e., the cost of raising funds in the case of interest in-

⁵⁵⁵ Council Directive 2003/49/EC of June 3, 2003 (“Interest and Royalty Directive”), Art. 1(1) and 1(7). Art. 1(1), read in light of Recitals 2 to 4 in the preamble to the Directive, concerns solely the tax position of the interest creditor; consequently, national legislation that does not lead to a reduction of the creditor’s income and does not subject the interest paid to any taxation in the hands of the beneficial owner of the interest, but only relates to the determination and method of calculating the basis of assessment of the business tax to be paid by the debtor of the interest is not the subject of Art. 1(1) (Case C-397/09, *Scheuten Solar Technology*).

come and research and development (R&D) expenditure in the case of royalties).

B. Scope of Application

1. Material Scope

The material scope of the Interest and Royalty Directive encompasses “interest” and “royalties.”

The term “interest” means income from debt claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor’s profits. It includes, in particular;

- (i) Income from securities; and
- (ii) Income from bonds or debentures,

including premiums and prizes attaching to such securities, bonds or debentures.

Penalty charges for late payment are not regarded as interest.

The term “royalties” means payments of any kind received as consideration for the use of, or the right to use, any of the following:

- (i) Any copyright of literary, artistic or scientific work, including cinematograph films and software;
- (ii) Any patent, trademark, design or model, plan, secret formula or process;
- (iii) Information concerning industrial, commercial or scientific experience; and
- (iv) Industrial, commercial or scientific equipment.⁵⁵⁶

The source State is not obliged to grant the benefits of the Interest and Royalty Directive with respect to:

- (i) Payments that are treated as distributions of profits or repayments of capital under the law of the source State;
- (ii) Payments on debt claims that carry a right to participate in the debtor’s profits (profit participating loans);
- (iii) Payments on debt claims that entitle the creditor to exchange its right to interest for a right to participate in the debtor’s profits (convertible bonds); or
- (iv) Payments on debt claims that contain no provision for repayment of the principal amount or where the repayment is due more than 50 years after the date of issue (perpetual debt).⁵⁵⁷

In other words, the source State is not required to apply the Directive to the following;

- (i) Payments treated as profit distributions or repayments of capital under its domestic law; and
- (ii) Certain payments on hybrid instruments.

In the case of the latter, however, even though the payments may not qualify for the benefits of the Interest and Royalty Directive, it is possible that the source State will have to refrain from taxing them because of the terms of the Parent-

⁵⁵⁶ Interest and Royalty Directive, Art. 2.

⁵⁵⁷ Interest and Royalty Directive, Art. 4(1).

Subsidiary Directive. Conversely, it is also possible that certain payments having the characteristics of profit distributions may fall within the scope of both the Interest and Royalty Directive and the Parent-Subsidiary Directive.

Where, by reason of a special relationship between the payer and the beneficial owner of interest or royalties, or between one of them and some other person, the amount of the interest or royalties exceeds the amount that would have been agreed by the payer and the beneficial owner in the absence of such a relationship, the provisions of the Directive apply only to the latter amount, if any.⁵⁵⁸

2. Personal Scope

For the purposes of the Interest and Royalty Directive, a “company of a Member State” means any company that:

- (i) Takes one of the forms listed in the Annex to the Directive;
- (ii) In accordance with the tax laws of a Member State, is considered to be resident in that Member State and is not, within the meaning of a tax treaty concluded with a third state, considered to be resident for tax purposes outside the European Union; and
- (iii) Is subject to one of the taxes listed in the Directive without being exempt, or to a tax that is identical or substantially similar to any of those taxes and that is imposed after the date of entry into force of the Directive in addition to, or in place of, any of those existing taxes.⁵⁵⁹

In addition, for the Interest and Royalty Directive to be applicable, both the creditor and debtor entities with respect to the interest or royalty payments must be “associated.” For these purposes, a company is an “associated company” of a second company if:

- (i) The first company has a direct minimum holding of 25% in the capital of the second company;
- (ii) The second company has a direct minimum holding of 25% in the capital of the first company; or
- (iii) A third company has a direct minimum holding of 25% both in the capital of the first company and in the capital of the second company.

Thus, indirect holdings are not covered. Moreover, holdings must involve only companies resident in the EU territory.⁵⁶⁰

Comment: The use of the word “holdings” is a potential source of uncertainty: does the Directive only require the subsidiary to be resident in one of the Member States or does the EU residence requirement also apply to the parent in the context of a triangular situation in which the parent company has a 25% interest in both the payer and the beneficial owner of the interest or royalty (in which case, payments between two EU subsidiaries with a common parent located, for example, in the United States would fall outside the scope of the Direc-

tive)? This uncertainty has been specifically addressed in the language used in the domestic implementing legislation of certain Member States. France and Belgium, for example, both require the parent company in a triangular situation to be a resident of the European Union.

A qualifying PE, i.e., a fixed place of business situated in a Member State through which the business of a company of another Member State is wholly or partly carried on,⁵⁶¹ is (also) eligible for the exemptions under the Directive. However, such a PE is treated as the payer of interest or royalties only to the extent the payments represent a tax-deductible expense for the PE in the Member State in which it is situated.⁵⁶²

Further, the qualifying recipient company or PE must be the beneficial owner of the income concerned (a test that is not provided for in the Parent-Subsidiary Directive). Under the Interest and Royalty Directive, a company of a Member State is treated as the beneficial owner of interest or royalties only if it receives the payments for its own benefit and not as an intermediary, such as an agent, trustee or authorized signatory, for some other person.⁵⁶³

A PE is treated as the beneficial owner of interest or royalties if:

- (i) The debt claim, right or use of information with respect to which the interest or royalty payments arise is effectively connected with the PE; and
- (ii) The interest or royalty payments represent income with respect to which the PE is subject in the Member State in which it is situated to one of the taxes listed in the Directive or to a tax that is identical or substantially similar to one of those taxes and that is imposed after the date of entry into force of the Directive in addition to, or in place of, one of those existing taxes.⁵⁶⁴

The beneficial owner concept employed by the Interest and Royalty Directive is similar to the beneficial owner concept included in the OECD Model Tax Convention. Hence, the OECD interpretation of “beneficial owner” may be used as a guideline when interpreting the term in the Directive.

The CJEU further clarified the concept of “beneficial owner” for the purposes of the Interest and Royalty Directive in a number of judgments rendered on February 26, 2019 (the “Danish cases”).⁵⁶⁵ In the Court’s interpretation, the concept of “beneficial owner of the interest” cannot refer to concepts of national law that vary in scope. Within the meaning of the Interest and Royalty Directive, the concept must therefore be interpreted as designating an entity that actually benefits from the interest that is paid to it. Article 1(4) of the Interest and Royalty Directive confirms that reference to economic reality by stating that a company of a Member State is to be treated as the bene-

⁵⁶¹ Interest and Royalty Directive, Art. 3(c).

⁵⁶² Interest and Royalty Directive, Art. 1(3).

⁵⁶³ Interest and Royalty Directive, Art. 1(4).

⁵⁶⁴ Interest and Royalty Directive, Art. 1(5).

⁵⁶⁵ Joined Case C-115/16, *N Luxembourg 1*, C-118/16, *X Denmark*, C-119/16, *C Denmark I* and C-299/16, *Z Denmark*. These judgments should be seen in close conjunction with the CJEU’s decisions rendered the same date in Joined Cases 116/16, *T Denmark* and 117/16, *Y Denmark*, which concerned the application of the Parent-Subsidiary Tax Directive (see IV.E., above), all these cases being commonly referred to as the “Danish cases” or the “Danish Beneficial Ownership” cases.

⁵⁵⁸ Interest and Royalty Directive, Art. 4(2).

⁵⁵⁹ Interest and Royalty Directive, Art. 3(a).

⁵⁶⁰ Interest and Royalty Directive, Art. 3(b). Member States have the option of replacing the criterion of a minimum holding in the capital with that of a minimum holding of voting rights.

ficial owner of interest or royalties only if it receives those payments for its own benefit and not as an intermediary, such as an agent, trustee or authorized signatory, for some other person. As such, the term “beneficial owner” refers not to a formally identified recipient but rather the entity that benefits economically from the interest received and, accordingly, has the power freely to determine the use to which it is put.

Furthermore, as is apparent from the legislative history of the Interest and Royalty Directive,⁵⁶⁶ the Directive draws on Article 11 of the OECD 1996 Model Tax Convention and pursues the same objective, i.e., the avoidance of international double taxation. The concept of “beneficial owner,” which appears in the bilateral conventions based on that Model, the successive amendments of that Model and the commentaries relating thereto are, therefore, relevant when interpreting the Interest and Royalty Directive. The Court further added that it is clear from the development of the OECD Model Tax Convention and the related commentaries that the concept of “beneficial owner” excludes conduit companies and must be understood not in a narrow technical sense but as having a meaning that enables double taxation to be avoided and tax evasion and avoidance to be prevented.

Comment: It is worth noting that the CJEU’s reliance on (an evolutionary interpretation of) the OECD Model Tax Convention and the related Commentaries for the purposes of interpreting the concept of “beneficial owner” deviates from the Opinion rendered in that respect by Advocate-General Kokott in the underlying cases. According to the Advocate-General, the OECD Model Tax Convention (as amended) is not a legally binding, multilateral convention under international law. It is a unilateral act of an international organization in the form of recommendations to its member countries. This applies *a fortiori* to the commentaries published by the OECD, which ultimately only contain legal opinions. While it is not inappropriate for the Member States to derive guidance for the balanced allocation of their fiscal competence from international practice, as reflected in the OECD Model Tax Convention (as amended) and the related commentaries, such commentaries cannot have a direct effect on the interpretation of an EU directive, even if the terms used are identical. Therefore, according to the Advocate-General, the concept of “beneficial owner” must be interpreted under EU law autonomously and independently of Article 11 of the 1977 OECD Model Tax Convention or its subsequent versions.

According to the Court, the concept of “beneficial owner” is connected to the CJEU’s abuse of rights” theory which states that a group of companies may be regarded as being an artificial arrangement where:

- (i) It is not set up for reasons that reflect economic reality;
- (ii) Its structure is purely one of form; and
- (iii) Its principal objective or one of its principal objectives is to obtain a tax advantage, contrary to the aim or purpose of the applicable tax law.

⁵⁶⁶ See the Proposal for a Council Directive on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States of March 6, 1998 (COM (1998) 67 final, which formed the basis of the Interest and Royalty Directive.

For example, tax may be avoided on a payment of interest due to a conduit company being interposed between the company paying the interest and the entity that is the beneficial owner of the interest. In the Court’s view, what indicates the existence of an arrangement intended to obtain improper entitlement to the exemption provided for in Article 1(1) of the Directive is the fact that all or almost all of the interest is, very soon after its receipt, passed on by the company that has received it to entities that do not fulfil the conditions for the application of the Directive, because such entities:

- (i) Are not established in any Member State;
- (ii) Are not incorporated in one of the forms referred to in the Annex to the Directive;
- (iii) Do not satisfy the “subject-to-tax” test; or
- (iv) Do not have “associated company status” within the meaning of the Directive.

Furthermore, an entity’s whose sole activity is the receipt of interest and its transmission to the beneficial owner or to other conduit companies should be regarded as a conduit company. The absence of actual economic activity must, in the light of the specific features of the economic activity in question, be inferred from an analysis of all the relevant factors relating, in particular, to the following:

- (i) The management of the company;
- (ii) The company’s balance sheet;
- (iii) The structure of the costs and expenditure actually incurred by the company;
- (iv) The staff employed by the company; and
- (v) The premises owned and/or occupied by the company; and
- (vi) The equipment owned and/or used by the company.

The Court added that indications of an artificial arrangement may also be constituted by the various contracts existing between the companies involved in the financial transactions at issue. This gives rise to intragroup flows of funds that, under Article 4 of the Directive, may have the aim of transferring profits from a profit-making commercial company to shareholding entities in order to avoid the tax burden or reduce it as much as possible.

Other indications of an artificial arrangement include:

- (i) The way in which the transactions are financed;
- (ii) The valuation of the intermediary companies’ equity; and
- (iii) The conduit companies’ inability to have economic use of the interest received.

In this connection, such indications are capable of being constituted not only by a contractual or legal obligation of the company receiving interest to pass it on to a third party but also by the fact that, “in substance,” that company, without being bound by such a contractual or legal obligation, does not have the right to use and enjoy the interest.

Moreover, such indications may be reinforced by the simultaneity or closeness in time of:

- (i) The entry into force of major new tax legislation (as was the case with the Danish legislation at issue), which some company groups are attempting to circumvent; and
- (ii) The setting up of complex financial transactions and the granting of intra-group loans.

In that respect, the fact that the Member State in which the interest arises has concluded a tax treaty with the third State in which the company that is the beneficial owner of the interest resides has no bearing on any finding of an abuse of rights.

Comment 1: Some commentators argue that determining whether a person or entity is the “beneficial owner” of a payment does not necessarily involve an analysis of the subjective nature of the structure and that, from that perspective, the linkage by the CJEU of the concept of “beneficial owner” to that of “abusive practices” (requiring both an objective and a subjective element in the CJEU’s interpretation) might be open to criticism. In the author’s opinion, this argument may be countered by paragraphs 7 to 10 of the Commentary on Article 1 of the OECD Model Tax Convention (as amended in 1977), which draw attention to the fact that the Convention could improperly be taken advantage of, with the objective of tax avoidance, using artificial legal constructions. The text of those paragraphs seems to encompass:

- (i) A subjective element, which would also apply in the context of the “beneficial owner” concept included, in particular, in Article 10 (Dividends) and Article 11 (Interest) of the OECD Model Tax Convention; and
- (ii) The need to combat tax evasion.

Comment 2: The concept of “artificial agreement,” as described in the Danish Beneficial Ownership cases, is arguably:

- (i) Broader than the concept of “abuse” developed in the CJEU’s case law concerning the “wholly artificial arrangement” test, as (further) elaborated in *Cadbury Schweppes* (see II.C.3.f. and II.E.4.d., above); and
- (ii) Closer to a principal purpose test, given that the CJEU appears to place far greater emphasis on the purpose of the taxpayer in adopting a particular structure in these judgments.

According to the CJEU, in circumstances where the tax authorities impute the existence of fictitious or deemed interest, no actual payment of interest is involved and, hence, the lender cannot be considered the beneficial owner for the purposes of the Interest and Royalties Directive.⁵⁶⁷ The relevant ruling was delivered in a case in which the (Bulgarian) tax authorities claimed, based on a domestic anti-abuse provision, that fictitious or deemed interest — on which a 10% withholding was due — should be imputed in the context of a convertible interest-free loan granted by a Luxembourg-based parent company to its Bulgarian subsidiary.

Finally, Member States have the option of not applying the Directive to:

- (i) A company of another Member State; or

- (ii) A PE of a company of another Member State,

if the minimum holding requirements set out above have not been met for an uninterrupted period of at least two years.⁵⁶⁸

Comment: The question arises as to whether the CJEU decision in the *Denkavit* case— according to which the minimum holding period does not have to be met at the precise moment dividends are distributed (for the purposes of the Parent-Subsidiary Tax Directive, see IV.B.2., above) — should also apply (if only by analogy) to the situations covered by the Interest and Royalty Directive. In the author’s opinion, the answer should be affirmative: the purpose of the minimum holding requirement is to counteract the abusive enjoyment of the benefits of the Directive obtained through temporary, purely tax-motivated holdings. This purpose is achieved if the holding is maintained for the required minimum period, regardless of whether that period has already come to an end at the time of payment or whether it comes to an end only at some later time, such as the date on which an application for relief is submitted.⁵⁶⁹

C. Elimination of Double Taxation

Interest or royalty payments arising in a Member State are exempt from any taxes imposed on those payments in that State, whether by deduction at source or by assessment, provided:

- (i) The beneficial owner of the interest or royalties is an associated company of another Member State or a PE situated in another Member State of a company of a Member State,⁵⁷⁰ and
- (ii) Such payments are subject to tax in that other State.⁵⁷¹

In other words, the Interest and Royalty Directive aims to:

- (i) Exempt interest and royalty payments from taxation at source, whether by way of assessment or withholding tax;
- (ii) Ensure that the beneficial owner of the payments is taxed in its Member State of residence or, in the case of a PE, in the Member State in which the PE is situated.

To this end, the source State may require that fulfillment of the conditions under the Directive be substantiated at the time of payment of the interest or royalties by an attestation. If there has been no such attestation at the time of payment, the source State is free to require the deduction of tax at source.⁵⁷² The source State may also make it a condition for exemption that

⁵⁶⁸ Interest and Royalty Directive, Art. 1(10).

⁵⁶⁹ See, in the same sense, Commission Report on the Functioning of the Interest and Royalty Directive, COM (2009) 179, at page 5.

⁵⁷⁰ Interest and Royalty Directive, Art. 1(1).

⁵⁷¹ Interest and Royalty Directive, Recitals (3) and (4). The freedom of establishment principle enshrined in the EEA Agreement may require that similar benefits be made available in situations involving a payer or payee company of, or PE situated in, an EEA State, provided the company or PE is comparable to the EU entity forms or PEs covered by the Directive. A non-EU Member State may also apply tax principles similar to the benefits provided by the Directive based on a separate, bilateral agreement concluded between a Member State and that non-Member State that duplicates the benefits available under the Directive.

⁵⁷² Interest and Royalty Directive, Art. 1(11). The attestation is, with respect to each contract for payment, valid for at least one year but for not more than three years from the date of issue and must contain the information indicated in Interest and Royalty Directive, Art. 1(13).

⁵⁶⁷ Case C-257/20, *Viva Telecom Bulgaria*. On the relationship between the Fundamental Freedoms and harmonizing secondary legislation, see II.C., above.

it has issued a decision currently granting the exemption following an attestation certifying the fulfillment of the (personal) conditions for exemption; such a decision must be issued within three months, at most, after the attestation.⁵⁷³ In the case, *Erdrich Umformtechnik*,⁵⁷⁴ concerning the refusal by the Czech tax authorities to grant an income tax exemption on royalty payments for earlier tax periods on the ground that the application had been submitted too late, the CJEU held that the Interest and Royalty Directive allows the source Member State to grant an exemption, by decision under Article 1(12) of the IRD, for a period preceding both the exemption decision itself and the submission of the attestation and supporting information required by the tax authorities. The Directive does not lay down any time limit for providing that attestation and supporting information, nor does it impose a limit on how far back such an exemption may apply.

If the paying company or PE has withheld at source tax that is to be exempted under the Directive, a claim may be made for the repayment of the tax withheld. The application for repayment must be submitted within the period laid down. This period, however, may not be less than two years from the date on which the interest or royalty payments are made.⁵⁷⁵ The source State must repay the excess tax withheld at source within one year following receipt of the application and such supporting information as it may reasonably ask for. If the tax withheld at source is not refunded within that period, the receiving company or PE is entitled, on expiration of the period in question, to interest on the tax refunded, at a rate corresponding to the national interest rate applicable in comparable cases under the domestic law of the source State.⁵⁷⁶

The Interest and Royalty Directive does not affect the application of domestic or agreement-based provisions that go beyond the provisions of the Directive and are designed to eliminate or mitigate the double taxation of interest and royalties.⁵⁷⁷ In light of the existing restrictions on the scope of the Interest and Royalty Directive (for example, the 25% holding requirement and the adoption of one of the qualifying corporate forms, which may impede tax-efficient structuring for US groups, in particular), double taxation agreements remain relevant in this context. By way of illustration, certain tax treaties (and, sometimes, even the domestic laws of certain jurisdictions) reduce the withholding taxes on interest or royalty payments to zero, without requiring compliance with requirements equivalent to the (strict) conditions laid down by the Directive.

D. Fraud and Abuse

The Interest and Royalty Directive does not preclude the application of domestic or agreement-based provisions required for the prevention of fraud or abuse.⁵⁷⁸ Article 5(1) of the Directive is similar to Article 1(2) of the Parent-Subsidiary Di-

rective (before its amendment in December 2014 — see IV.E., above).

Moreover, 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 the Directive or refuse to apply the Directive.⁵⁷⁹ Article 5(2) of the Directive is similar to the first sentence of Article 15(1a) of the Merger Directive (see III.D., above).

The question as to whether, to combat an abuse of rights in the context of applying the Interest and Royalty Directive, a Member State must have adopted a specific domestic provision transposing that Directive or whether it may refer to domestic or agreement-based anti-abuse principles or provisions, is addressed by the CJEU in the Danish cases discussed in V.B.2., above.

The Court's response is that it is settled case law that there is, in EU law, a general legal principle that EU law cannot be relied on for abusive or fraudulent ends. It follows from that principle that a Member State must refuse to grant the benefit of the provisions of EU law where they are relied upon not with a view to achieving the objectives of those provisions but with the aim of benefiting from an advantage in EU law although the conditions for benefiting from that advantage are fulfilled only formally. That is also the case in the context of the Interest and Royalty Directive.

First, while Article 5(1) of the Directive provides that it is not to preclude the application of domestic or agreement-based provisions required for the prevention of fraud or abuse, that provision cannot be interpreted as excluding the application of the general principle of EU law that abusive practices are prohibited.

Second, while Article 5(2) of the Directive provides that Member States may, in the event of tax evasion, avoidance or abuse, withdraw the benefits of the Directive or refuse to apply it, that provision cannot be interpreted as excluding the application of the principle of EU law that abusive practices are prohibited, since the application of that principle is not — as the provisions of the Directive are — subject to a requirement of transposition.

Thus, in the light of the general principle of EU law that abusive practices are prohibited and the need to ensure observance of that principle when EU law is implemented, the absence of domestic or agreement-based anti-abuse provisions does not affect the national authorities' obligation to refuse to grant entitlement to rights provided for by the Interest and Royalty Directive where they are invoked for fraudulent or abusive ends.

Comment: Referring extensively to the CJEU's judgment in Case C-321/05, *Kofoed* (rendered in the context of the Merger Directive), Advocate-General Kokott took the opposite view. According to the Advocate-General, a Member State cannot hold a taxpayer to a provision of a directive that it has not transposed; nor can the tax authorities take a position against a taxpayer relying directly on the general principle of EU law that abuse of rights is prohibited.

⁵⁷³ Interest and Royalty Directive, Art. 1(12).

⁵⁷⁴ Case C-828/24, *Erdrich Umformtechnik*.

⁵⁷⁵ Interest and Royalty Directive, Art. 1(15). Article 1(15) does not govern exemption applications under Article 1(12); see the above-referenced Case C-828/24, *Erdrich Umformtechnik*.

⁵⁷⁶ Interest and Royalty Directive, Art. 1(16).

⁵⁷⁷ Interest and Royalty Directive, Art. 9.

⁵⁷⁸ Interest and Royalty Directive, Art. 5(1).

⁵⁷⁹ Interest and Royalty Directive, Art. 5(2).

E. Proposed Recast of Interest and Royalty Directive

In June 2006, the Commission published a Survey on the Implementation of the Interest and Royalty Directive.⁵⁸⁰ The Survey provides a comprehensive overview of the implementation of the Interest and Royalty Directive (and the application of Article 15(2) of the Agreement between the European Union and the Swiss Confederation in the Member States covered).

On April 23, 2009, in execution of its review obligation as laid down in Article 8 of the Directive, the Commission adopted a report on the functioning of the Interest and Royalty.⁵⁸¹ The report covers a wide range of issues concerning the transposition and implementation of the Directive. While, overall, the implementation has been considered satisfactory, the report highlights a number of transposition and interpretation issues that require improvement or clarification, such as:

- (i) The tax residence of the beneficiary of the payment;
- (ii) The holding thresholds and the period for qualifying as an associated company;
- (iii) The interrelation between the Interest and Royalty Directive and the Parent-Subsidiary Directive; and
- (iv) The application of the anti-fraud and anti-abuse clause.

Against this backdrop, on November 11, 2011, the Commission submitted a proposal for a full recast of the Interest and Royalty Directive (the “Proposed Interest and Royalty Recast Directive”).⁵⁸²

In the years since 2011, work has advanced on the Proposed Interest and Royalty Recast Directive. However, in its 2025 Work Program published on February 11, 2025, the Commission notes that the Proposed Interest and Royalty Recast Directive has been deemed obsolete in light of the Pillar Two Directive and will therefore be withdrawn. Such withdrawal needs to be formally published in the EU Official Journal in order for the legislative process to end. The following however sets out the work that was done on the Directive in this time.

The Proposed Interest and Royalty Recast Directive was mainly intended to:

- (i) Widen the scope of the Directive to include a new set of eligible companies in line with the scope of the Parent-Subsidiary Directive, including SEs and SCEs;
- (ii) Reduce the currently applicable 25% minimum holding percentage to 10%;
- (iii) Broaden the definition of “associated company” to include indirect shareholdings;
- (iv) Extend the exemption requirements to close existing loopholes (for example, interest and royalty income will

have to be subject to corporate income tax in the hands of the recipient); and

- (v) Clarify the requirements for treating a PE as a payer of interest or royalties (for the purposes of benefiting from the exemption), by replacing the condition that the payments represent tax deductible expenses at the level of the PE with the condition that the payments must be incurred for the purposes of the PE’s activity.⁵⁸³

According to the Commission, the impact assessment revealed that the new provisions would generate compliance cost savings for EU companies amounting to between 38.4 and 58.8 million euros. On the other hand, the proposed changes would result in net losses in tax revenue of between 160 and 310 million euros for Member States that currently subject outbound interest and royalty payments to withholding tax. The proposed transposition deadline for Member States was January 1, 2012, with the recast Directive being applicable as from January 1, 2013.

This deadline was not achieved. In June 2015, following a period of relative silence, the Latvian Presidency (January–June 2015) proposed splitting the Proposed Interest and Royalty Recast Directive and concentrating first on the insertion of a *de minimis* anti-abuse provision, similar to that introduced into the Parent-Subsidiary Directive (see IV.E., above).

Unable to reach political agreement, the Member States decided, instead, to build on the “effectively subject to tax” requirement that the Commission had inserted into the Proposed Interest and Royalty Recast Directive (see above). This work resulted, under the January–June 2016 Dutch Presidency, in a proposal to define “effectively subject to tax” by reference to a minimum tax threshold. It was proposed to calculate effective taxation based on the isolated method: the reference effective tax rate would be that borne on the interest or royalty payments (i.e., the result would not be affected by the individual profit or loss made by each particular taxpayer deriving from any given payment) and the minimum rate would be an absolute figure of 10%.

In practice, the proposal would mean that a payment of interest or royalties would be exempted from taxes in the Member State in which it arose when the effective tax rate under the tax regime applicable to the payment in the Member State of residence of the beneficial owner was at least 10%. It was further specified that the effective tax rate would take into account any tax reduction directly linked to inbound royalty or interest payments. By contrast, any tax credit or allowance not directly linked to such inbound payments (for example, tax credits for R&D expenditure incurred prior to the existence of an intangible asset whose exploitation gave rise to a royalty payment) would not be taken into account.

Furthermore, the Dutch Presidency proposed to study a possible exception for patent box regimes that were compliant with the (OECD BEPS-driven) nexus approach. This exception could be drafted in the form of a substance test, or a minimum tax rate could be fixed below the general threshold of 10%.

⁵⁸⁰ The Survey was carried out by the International Bureau of Fiscal Documentation (IBFD).

⁵⁸¹ COM (2009) 179; the report was originally scheduled for submission to the Council by December 31, 2006, but because of ongoing discussions in the Council on the Commission’s December 30, 2003 proposal to amend the Directive, it was decided to postpone the date of adoption.

⁵⁸² Proposal for a Council Directive on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States (recast), COM (2011) 714 final.

⁵⁸³ Points (i) and (iv) had already been included in the Commission’s proposal of December 30, 2003 to amend the Interest and Royalty Directive, which was withdrawn in 2010.

Absent any political consensus on this proposal, the Slovak Presidency (July–December 2016) subsequently explored a possible “ownership/base erosion test” inspired by the BEPS “Limitation on Benefits” clause, while the Maltese Presidency (January–June 2017) suggested that the Directive should not apply where interest and royalty payments are made to jurisdictions with harmful preferential regimes, which would include indirect remittances to third countries on the EU list of non-cooperative jurisdictions for tax purposes. However, no agreement could be reached on any of these suggestions. In its Presidency roadmap, setting out the future work of the Council in the field of BEPS, the Estonian Presidency (July–December 2017) announced that it would explore how to take the Proposed Interest and Royalty Recast Directive forward, which it labeled as medium-term work. Years of relative silence followed.

It was not until the Commission Communication “Business Taxation for the 21st Century” dated May 18, 2021,⁵⁸⁴ that the Proposed Interest and Royalty Recast Directive was once more aggressively put on the agenda. In that Communica-

tion, the Commission stated that the transposition of the OECD BEPS Pillar Two at the EU level — i.e., the Pillar Two Directive (see the discussion at VII.A., below) — was expected to pave the way for agreement on the Proposed Interest and Royalty Recast Directive. As noted above, the aim of the Proposed Interest and Royalty Recast Directive is to make the benefits of the Directive conditional on the interest being subject to tax in the destination State. Some Member States held the view that the Interest and Royalty Directive should go further and set a minimum level of tax in the destination state as a condition for benefiting from the absence of withholding tax. According to the Commission, the Pillar Two Directive resolves this issue and, hence, the way to a formal adoption of the Proposed Interest and Royalty Recast Directive was expected to be open, before the Commission’s decision that it was not necessary in February 2025.

⁵⁸⁴ See, https://taxation-customs.ec.europa.eu/system/files/2021-05/communication_on_business_taxation_for_the_21st_century.pdf.

VI. Anti-Tax Avoidance Directives

A. Overview

Executive Summary

This Section discusses ATAD 1, which comprises: a general interest limitation rule; a provision on exit taxation; a general anti-avoidance rule (GAAR); controlled foreign company (CFC) rules; and a framework for countering hybrid mismatches that addresses both hybrid entities and hybrid instruments in intra-EU situations.

It also considers ATAD 2, which is a supplement to ATAD 1 that extends the framework for countering hybrid mismatches in situations where third countries are involved.

In its June 18, 2025 Report on Tax Issues, ECOFIN announced the discontinuation of the analysis of the Anti-Shell Proposal (ATAD 3) in view of its potential overlaps with the hallmarks set out in DAC 6. See discussion at IX.B.5. and XXI.K., below.

Council Directive (EU) 2016/1164 laying down rules targeted at tax avoidance practices that directly affect the functioning of the internal market, commonly referred to as the Anti-Tax Avoidance Directive or ATAD (now “ATAD 1”), was formally adopted on July 12, 2016,⁵⁸⁵ constituting a major step in the implementation of the outcomes of the OECD BEPS project.⁵⁸⁶

ATAD 1 was initially launched by the Commission on January 28, 2016 (the “Initial Proposal”). The Initial Proposal underwent (repeated) amendments, mostly to reduce or otherwise mitigate the scope of the proposed measures. Political agreement on a compromise version of the Directive was reached on June 17, 2016, subject to a “silence period” that expired (without any objections having been submitted) at midnight on June 20, 2016.

ATAD 1 forms part of the Anti-Tax Avoidance Package launched by the Commission on the same date.⁵⁸⁷

ATAD 1 sets out minimum standards that all Member States must implement. Recital (14) of its preamble explicitly

states that the implementation of ATAD 1 should not affect a taxpayer’s obligation to comply with the arm’s-length principle or a Member State’s right to adjust a tax liability upwards in accordance with the arm’s-length principle. Furthermore, ATAD 1 should not preclude the application of domestic or agreement-based provisions aimed at providing a higher level of protection for domestic corporate tax bases. It is intended to apply to all taxpayers subject to corporate tax in a Member State, including corporate taxpayers resident outside the European Union with PEs in the European Union.

The schemes targeted by ATAD 1 involve situations in which taxpayers act against the actual purpose of the law, taking advantage of disparities between national tax systems, to reduce their tax bills. Taxpayers may benefit from low tax rates or double deductions or they may ensure that their income remains untaxed by making it deductible in one jurisdiction while not being included in the tax base across the border. The outcome of such situations distorts business decisions in the internal market and, unless it is effectively tackled, could create an environment of unfair tax competition.

To this end, ATAD 1 includes five measures:

- (i) A general interest limitation rule;
- (ii) A provision on exit taxation;
- (iii) A GAAR;
- (iv) Controlled foreign company (CFC) rules; and
- (v) A framework for countering hybrid mismatches that addresses both hybrid entities and hybrid instruments.

The “switch-over clause” included in the Initial Proposal (under which Member States would have to apply a credit system with respect to certain types of foreign income originating from third countries instead of an exemption if the entity or PE from which the income originated was taxed at a corporate tax rate lower than 40% of the statutory (not the effective) corporate tax rate that would have been charged in the Member State of the taxpayer) was eventually abandoned in the final version of ATAD 1.

As regards hybrid mismatches, Council Directive (EU) 2017/952 of May 29, 2017, amending Directive (EU) 2016/1164, commonly referred to as “ATAD 2,” extended the ATAD 1 hybrid mismatch rules to hybrid mismatches with third countries (see VI.B.6., below).

On December 22, 2021, the Commission presented a Proposal for a Council Directive laying down rules to prevent the misuse of shell entities for tax purposes and amending Directive 2011/16/EU, also commonly referred to as the “Anti-Shell Proposal,” the “Unshell Proposal” or “ATAD 3,” targeting the perceived misuse of shell entities for improper tax purposes in the European Union.

B. ATAD 1 and ATAD 2

1. General

ATAD 1 includes five measures:

- (i) A general interest limitation rule;
- (ii) A provision on exit taxation;
- (iii) A GAAR;

⁵⁸⁵ OJ L 193/2 of July 19, 2016.

⁵⁸⁶ In the context of the OECD BEPS project, most Member States have committed to implementing the measures contained in the BEPS Final Reports, which were published on October 5, 2015 and endorsed by G20 leaders in November 2015. According to the Commission, however, the unilateral and divergent implementation of BEPS by each Member State could fragment the Single Market by creating national policy clashes, distortions and tax obstacles for businesses in the European Union. It could also create new loopholes and mismatches that could be exploited by companies seeking to avoid taxation, thereby undermining Member States’ efforts to prevent such practices. It is therefore essential for the good functioning of the Single Market that Member States — as a minimum — transpose the OECD BEPS measures into their national systems in a coherent and coordinated fashion; hence, the choice of a directive as the instrument for achieving that purpose.

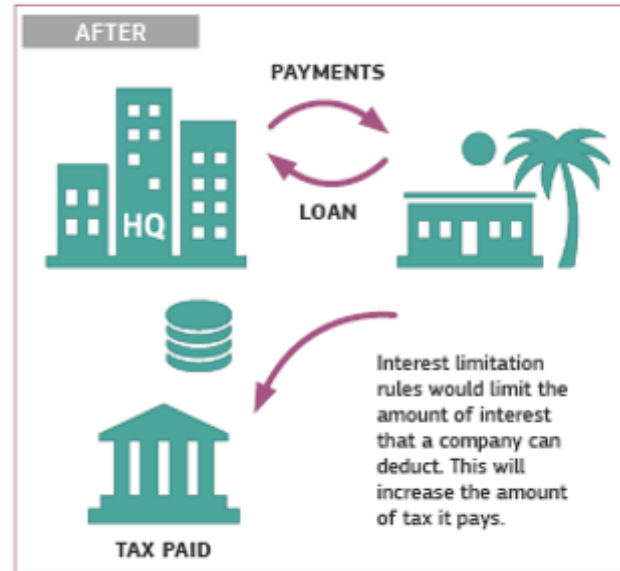
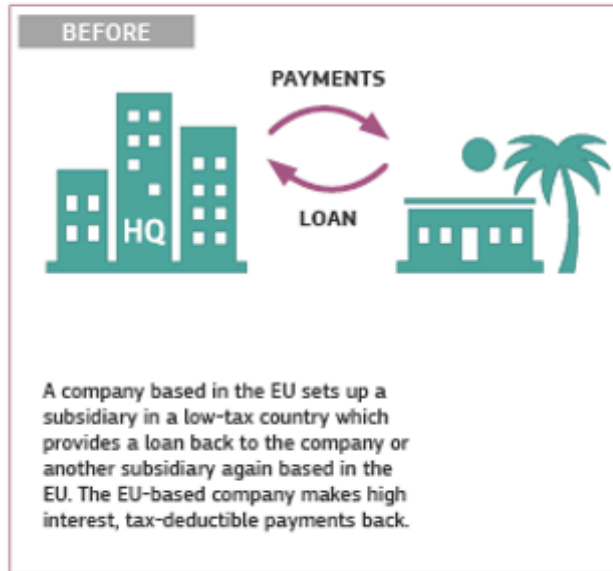
⁵⁸⁷ Besides the Initial Proposal, the Package included (i) a Country-by-Country Reporting Proposal; (ii) a Communication proposing a framework for a new EU external strategy for effective taxation; and (iii) a Recommendation on the implementation of measures countering tax treaty abuse; see, https://ec.europa.eu/commission/presscorner/detail/en/IP_16_159.

- (iv) Controlled foreign company (CFC) rules; and
- (v) A framework for countering hybrid mismatches that addresses both hybrid entities and hybrid instruments.

ATAD 2 extends the ATAD 1 hybrid mismatch rules to hybrid mismatches with third countries.

2. Interest Limitation Rule

THE LOW TAX LOANS: Interest Limitation Rules



Source: https://taxation-customs.ec.europa.eu/taxation-1/company-taxation/anti-tax-avoidance-directive_en.

Building on the outcome of OECD BEPS Action 4 (*Limitations on Interest Deductions*),⁵⁸⁸ ATAD 1 limits the deduction of “exceeding borrowing costs” to 30% of a taxpayer’s earnings before interest, tax, depreciation and amortization (EBITDA).⁵⁸⁹

For this purpose, the phrase “exceeding borrowing costs” means the amount by which, under national law, the deductible borrowing costs of a taxpayer exceed taxable interest revenues and other economically equivalent taxable revenues that the taxpayer receives.⁵⁹⁰

“Borrowing costs” are defined as interest expenses on all forms of debt, other costs economically equivalent to interest and expenses incurred in connection with the raising of finance, as defined in national law, including, without being limited to, the following:

- (i) Payments under profit participating loans;
- (ii) Imputed interest on instruments such as convertible bonds and zero coupon bonds;

⁵⁸⁸ The OECD’s final report on BEPS Action 4 recommends a three-tiered approach to limiting interest deductions: a fixed ratio rule based on a benchmark net interest/EBITDA ratio; a group ratio rule which may allow an entity to deduct more interest expense depending on the relative net interest/EBITDA ratio of the worldwide group; and targeted rules to address specific risks. See, OECD (2015), *Limiting Base Erosion Involving Interest Deductions and Other Financial Payments, Action 4 — 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, <https://doi.org/10.1787/9789264241176-en>.

⁵⁸⁹ ATAD 1, Art. 4(1). Thus, the deductibility rate is set at the top end of the scale of 10–30% recommended by the OECD.

⁵⁹⁰ ATAD 1, Art. 2(2).

(iii) Amounts under alternative financing arrangements, such as Islamic finance;

(iv) The finance cost element of finance lease payments;

(v) Capitalized interest included in the balance sheet value of a related asset or the amortization of capitalized interest;

(vi) Amounts measured by reference to a funding return under transfer pricing rules, where applicable;

(vii) Notional interest amounts under derivative instruments or hedging arrangements related to an entity’s borrowings;

(viii) Certain foreign exchange gains and losses on borrowings and instruments connected with the raising of finance; and

(ix) Guarantee fees for financing arrangements, arrangement fees and similar costs related to the borrowing of funds.⁵⁹¹

Under the general interest limitation rule, Member States may also treat as a taxpayer:

(i) An entity permitted or required to apply the rules on behalf of a group, as defined under national tax law; and

(ii) An entity in a group, as defined under national tax law, that does not consolidate the results of its members for tax purposes — in such circumstances, exceeding borrowing costs and EBITDA may be calculated at the level of the group and comprise the results of all the group members.⁵⁹²

⁵⁹¹ ATAD 1, Art. 2(1).

⁵⁹² ATAD 1, Art. 4(1). As indicated, it is questionable whether in light of the case law of the CJEU the Member States’ option to treat a domestic group

EBITDA is calculated by adding back to the income subject to corporate tax in the Member State of the taxpayer:

- (i) The tax-adjusted amounts for exceeding borrowing costs; and
- (ii) The tax-adjusted amounts for depreciation and amortization.

Tax-exempt income is excluded from a taxpayer's EBITDA.

The aim of the rule is to discourage multinational groups from financing group entities in high-tax jurisdictions through debt and arranging for such entities to pay back "inflated" interest to subsidiaries resident in low-tax jurisdictions. In this way, the tax base of the group (or, more accurately, of the entities paying out such "inflated" interest) decreases in the high-tax jurisdictions while increasing in the low-tax State where the interest payments are received. Thus, the rule essentially mitigates the bias against equity financing and may result in a shift from debt financing to equity financing.

The limitation applies without distinction as to the origin of the debt. For example, it is not relevant whether the interest is related to intra-group, third-party, EU or third-country debt. However, Member States may opt to exclude financial undertakings from the scope of application of the limitation, including where such financial undertakings are part of a consolidated group for financial accounting purposes.⁵⁹³

Some scope for mitigating the application of the rules is specifically provided for in ATAD 1, as follows.

First, Member States may opt to exclude from the concept of "exceeding borrowing costs" borrowing costs incurred with respect to a loan:

- (i) Concluded before June 17, 2016 (without such exclusion extending to any subsequent modification of the loan) (grandfathering clause); or
- (ii) Used to fund a long-term public infrastructure project (i.e., a project to provide, upgrade, operate and/or maintain a large-scale asset considered to be in the general public interest by a Member State) where the project operator, borrowing costs, assets and income are all in the European Union.⁵⁹⁴

Secondly, the taxpayer may be given the right to:

- (i) Deduct exceeding borrowing costs up to 3 million euros (if necessary, considered in relation to the entire group) (safe harbor rule);⁵⁹⁵ or
- (ii) Fully deduct exceeding borrowing costs if the taxpayer is a standalone entity (i.e., a taxpayer that is not part of a

consolidated group for financial accounting purposes and has no associated enterprise or PE).⁵⁹⁶

Thirdly, where the taxpayer is a member of a consolidated group for financial accounting purposes, the taxpayer may be given the right either to:

- (i) Fully deduct fully its exceeding borrowing costs if it can demonstrate that the ratio of its equity to its total assets is equal to or higher than the equivalent ratio of the group, subject to the following conditions:

- (a) The ratio of the taxpayer's equity to its total assets is considered to be equal to the equivalent ratio of the group: this will be the case if the ratio of the taxpayer's equity to its total assets is no more than two percentage points lower than the ratio of the group as a whole; and
- (b) All assets and liabilities are valued using the same method as in the consolidated financial statements; or

- (ii) Deduct exceeding borrowing costs in an amount in excess of what it would be entitled to deduct under the general rule, this higher limit on the deductibility of exceeding borrowing costs referring to the consolidated group for financial accounting purposes of which the taxpayer is a member and being calculated in two steps:

- (a) The group ratio is first determined by dividing the exceeding borrowing costs of the group *vis-à-vis* third-parties by the EBITDA of the group; and
- (b) The group ratio is then multiplied by the EBITDA of the taxpayer.⁵⁹⁷

For this purpose, a "group" consists of all entities included in audited consolidated statements drawn up in accordance with the accounting rules applicable in a Member State, International Financial Reporting Standards (IFRS) or other accounting standards the taxpayer may be allowed to use.

Finally, the Member State of the taxpayer may provide rules for:

- (i) The carryforward without time limitation of exceeding borrowing costs that cannot be deducted in the current tax period;
- (ii) The carryforward without time limitation and the carryback for a maximum of three years of exceeding borrowing costs that cannot be deducted in the current tax period; or
- (iii) The carryforward without time limitation of exceeding borrowing costs and, for a maximum of five years, unused interest capacity that cannot be deducted in the current tax period.

Member States were required, by December 31, 2018, to adopt and publish the laws, regulations and administrative provisions necessary to comply with the interest limitation rule set out in ATAD 1 and to apply those provisions from January 1, 2019. However, Member States that had national targeted rules for preventing BEPS risks at the date of the entry into force of ATAD 1 that were equally effective as the interest limitation

as a single taxpayer, meaning that domestic payments between members of the tax group are effectively disregarded (as the interest expense of one group member matches the interest income of another), whereas no similar group perspective is available for EU cross-border groups) is "fundamental freedom"-proof (see, ILE.4.n.).

⁵⁹³ ATAD 1, Art. 4(8).

⁵⁹⁴ ATAD 1, Art. 4(4).

⁵⁹⁵ Cf. the Initial Proposal, which limited the deduction of net interest expenses to an amount of 30% of the taxpayer's earnings before net interest, tax, depreciation and amortization (EBITDA) or up to an amount of 1 million euros, whichever was higher. Under the ATAD, the (higher) alternative threshold of 3 million euros (see below) is optional for Member States.

⁵⁹⁶ ATAD 1, Art. 4(3).

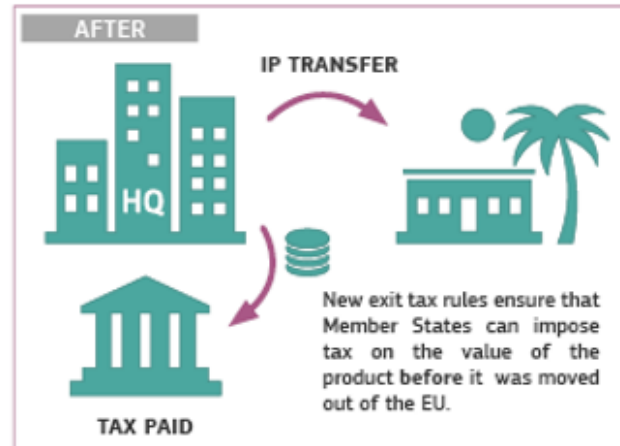
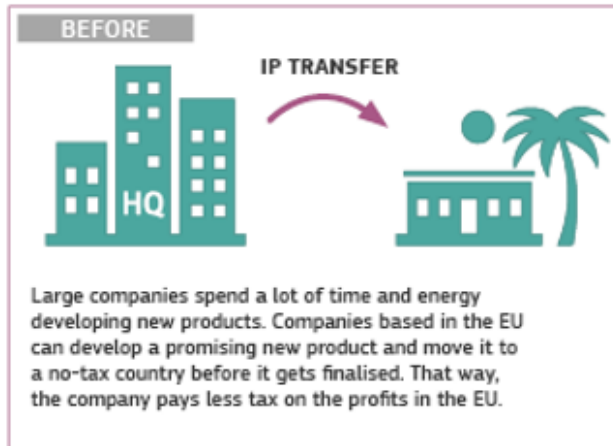
⁵⁹⁷ ATAD 1, Art. 4(5).

rule set out in ATAD 1 were allowed to apply these targeted rules until the end of the first full fiscal year following the date of publication of the agreement between the OECD members on the official website on a minimum standard with regard to BEPS Action 4, or until January 1, 2024, whichever was earlier. As no such minimum standard had been agreed, Member

States have not been allowed to apply the targeted rules since January 1, 2024.

3. Exit Taxation

THE PATENT FLIGHT: New Exit Taxation Rules



Source: https://taxation-customs.ec.europa.eu/taxation-1/company-taxation/anti-tax-avoidance-directive_en.

ATAD 1 requires a Member State to impose an exit tax upon a transfer of assets or a transfer of residence by a taxpayer out of the tax jurisdiction of that Member State. This includes:

- (i) The transfer of assets from a head office to a PE in another Member State or a third country, as well as the transfer of assets from a PE to a head office or a PE in another Member State;
- (ii) The transfer of tax residence to another Member State or to a third country, except to the extent the assets concerned remain effectively connected with a PE in the original Member State; and
- (iii) The transfer of a PE out of a Member State.

For these purposes:

- (i) “Transfer of assets” means an operation whereby the right to tax the transferred assets passes to another Member State or third country, while the assets remain under the beneficial ownership of the same taxpayer, excluding a transfer of assets of a temporary nature as long as the assets are intended to revert to the Member State of the transferor;
- (ii) “Transfer of tax residence” means an operation whereby a taxpayer ceases to be resident for tax purposes in a Member State and acquires tax residence in another Member State or a third country; and
- (iii) “Transfer of a permanent establishment” means an operation whereby a taxpayer ceases to have taxable presence in a Member State and acquires such presence in another Member State or a third country without becoming resident for tax purposes in that other Member State or third country.⁵⁹⁸

The Member State must tax unrealized capital gains on the assets transferred, i.e., the difference between the market value and the book value of the assets transferred.⁵⁹⁹ If the assets, tax residence or PE are transferred to another Member State, that Member State must accept the market value established by the Member State of origin as the starting value of the assets for tax purposes.⁶⁰⁰ For this purpose, “market value” is the amount for which an asset can be exchanged or mutual obligations can be settled between willing unrelated buyers and sellers in a direct transaction.⁶⁰¹

In the case of a transfer to a Member State or to a third country that is party to the European Economic Area (EEA) Agreement, the taxpayer must have the right either to pay the exit tax immediately or to defer payment of the tax over at least five years and to settle the tax liability via staggered payments.⁶⁰² According to the Commission, this makes the provision compliant with the case law of the CJEU.⁶⁰³ Where the taxpayer opts for deferral, the Member State may impose an interest charge.⁶⁰⁴ The Member State may also request a guarantee as a condition for deferral if there is a demonstrable and actual risk of non-recovery, and the legislation does not provide for the possibility of recovering the tax debt through another taxpayer that is a member of the same group and a tax resident of that Member State.⁶⁰⁵

The tax becomes immediately recoverable if:

⁵⁹⁸ ATAD 1, Art. 2(5)–(7).

⁵⁹⁹ ATAD 1, Art. 5(1).

⁶⁰⁰ ATAD 1, Art. 5(5).

⁶⁰¹ ATAD 1, Art. 5(6).

⁶⁰² ATAD 1, Art. 5(2).

⁶⁰³ See the discussion at I.I.E.4.f., above.

⁶⁰⁴ ATAD, Art. 5(3), first subpara.

⁶⁰⁵ ATAD, Art. 5(3), second and third subparas.

- (i) The transferred assets are disposed of or subsequently transferred to a third country;
- (ii) The taxpayer's tax residence or its PE is subsequently transferred to a third country; or
- (iii) The taxpayer becomes bankrupt or is wound up.⁶⁰⁶

No exit tax may be levied when the transfer is of a temporary nature and the assets are intended to revert to the Member State of the transferor, for example:

- (i) Where the transfer is made to meet prudential requirements;

- (ii) Where the transfer is made for the purpose of liquidity management;
- (iii) In the case of securities financing transactions; or
- (iv) In the case of assets posted as collateral.⁶⁰⁷

Member States were required to adopt and publish the laws, regulations and administrative provisions necessary to comply with the exit tax rules by December 31, 2019 and to apply those provisions from January 1, 2020 onwards.

4. General Anti-Abuse Rule

⁶⁰⁶ ATAD, Art. 5(4).

⁶⁰⁷ ATAD, Art. 5(7).

THE SAFETY NET: A General Anti-Abuse Rule (GAAR)



Source: https://taxation-customs.ec.europa.eu/taxation-1/company-taxation/anti-tax-avoidance-directive_en.

ATAD 1 includes a general anti-abuse rule (GAAR) designed to cover gaps that may exist in a country's domestic anti-abuse rules. According to the Commission, the GAAR is designed to reflect the "wholly artificial test" of the CJEU,⁶⁰⁸ the term "wholly artificial" being reformulated as "non-genuine."

A non-genuine arrangement or a series of such arrangements entered into for the essential purpose of obtaining a tax advantage that defeats the object or purpose of the otherwise applicable tax provision must be ignored for the purposes of calculating the corporate tax liability.⁶⁰⁹

An arrangement or a series of arrangements is regarded as non-genuine to the extent it is not put in place for valid commercial reasons that reflect economic reality.⁶¹⁰

The tax liability must be calculated by reference to economic substance in accordance with national law.⁶¹¹

Member States were required to adopt and publish the laws, regulations and administrative provisions necessary to comply with the GAAR set out in the ATAD by December 31, 2018, and to apply those provisions from January 1, 2019.

⁶⁰⁸ See the discussion at II.C.3.f., above.

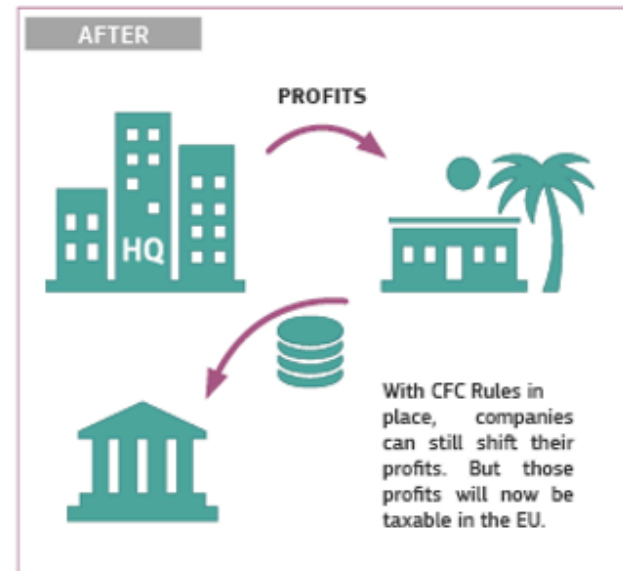
⁶⁰⁹ ATAD 1, Art. 7(1).

⁶¹⁰ ATAD 1, Art. 7(2).

⁶¹¹ ATAD, Art. 7(3).

5. Controlled Foreign Company Rules

THE CLASSIC PROFIT SHIFT: Controlled Foreign Companies (CFC) Rules



Source: https://taxation-customs.ec.europa.eu/taxation-1/company-taxation/anti-tax-avoidance-directive_en.

Inspired by OECD BEPS Action 3 (*Strengthening Controlled Foreign Company Rules*),⁶¹² ATAD 1 requires Member States to apply controlled foreign company (CFC) rules to taxpayers with CFCs (whether entities or PEs) in low-tax jurisdictions with a certain amount of mobile passive income.⁶¹³ The CFC rules attribute non-distributed income of a low-taxed CFC to its parent company by including it in the tax base of the parent.⁶¹⁴

An entity, or a PE, whose profits are not subject to tax or are exempt from tax in the Member State of the taxpayer, is to be treated by that Member State as a CFC if:

(i) The taxpayer, by itself or together with its associated enterprises:

- Holds a direct or indirect participation of more than 50% of its voting rights;
- Owns directly or indirectly more than 50% of its capital; or

⁶¹² The OECD 2015 Action 3 report set out recommendations in the form of building blocks for the design of effective CFC rules, which include the definition of a CFC, exemptions and thresholds, approaches for determining the type of income subject to the rule, computation of CFC income, the attribution of CFC income to shareholders and measures to eliminate the risk of double taxation. These recommendations are not minimum standards, but are designed to ensure that jurisdictions that choose to implement them will have rules that effectively prevent taxpayers from inappropriately shifting income into foreign subsidiaries. See, OECD (2015), *Designing Effective Controlled Foreign Company Rules, Action 3 — 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, <https://doi.org/10.1787/9789264241152-en>.

⁶¹³ Unlike the Initial Proposal, ATAD 1 includes financial undertakings that are tax resident in the European Union or the EEA and EU and EEA PEs of financial undertakings in the scope of the CFC rules.

⁶¹⁴ ATAD 1, Art. 7(1).

- Is entitled to receive more than 50% of its profits; and

(ii) The actual corporate tax paid on its profits by the entity or PE is lower than the difference between the corporate tax that would have been charged on the entity or PE under the applicable corporate tax system in the Member State of the taxpayer and the actual corporate tax paid on its profits by the entity or PE.⁶¹⁵

For the purposes of (ii), the PE of a CFC that is not subject to tax or is exempt from tax in the jurisdiction of the CFC should not be taken into account. Furthermore, the corporate tax that would have been charged in the Member State of the taxpayer refers to the tax as computed according to the rules of the Member State of the taxpayer.⁶¹⁶

Where the CFC rules apply, the Member State of the taxpayer must apply one of the following two options to include the qualifying non-distributed income of the CFC in its tax base:⁶¹⁷

(i) *Option 1*: Inclusion of the non-distributed income of the CFC that falls into the following categories:

- (a) Interest or any other income generated by financial assets;
- (b) Royalties or any other income generated from intellectual property (IP);
- (c) Dividends and income from the disposal of shares;
- (d) Income from financial leasing;

⁶¹⁵ Unlike the Initial Proposal, the text omits reference to a specific effective tax rate threshold below which the CFC rule would be triggered, although the rule is likely to apply where the rate of the actual corporate tax paid by the CFC is less than half the effective tax rate in the Member State of the taxpayer.

⁶¹⁶ ATAD 1, Art. 7(1)(a) and (b).

⁶¹⁷ ATAD 1, Art. 7(2).

- (e) Income from insurance, banking and other financial activities; and
- (f) Income from invoicing companies that earn sales and services income from goods and services purchased from and sold to associated enterprises that add no or little economic value.⁶¹⁸

The income to be included in the tax base of the taxpayer (in proportion to the taxpayer's participation in the entity concerned) must be calculated in accordance with the rules of the corporate tax law of the Member State in which the taxpayer is resident for tax purposes or in which it is situated. Losses of the entity or PE should be included in the tax base but may be carried forward, in accordance with national law, and taken into account in subsequent tax periods. However, no such inclusion is allowed where the CFC carries on a substantive economic activity supported by staff, equipment, assets and premises, as evidenced by relevant facts and circumstances.⁶¹⁹ Moreover, Member States may opt not to treat an entity or PE as a CFC if no more than one third of the income accruing to the entity or PE falls within the above categories. Member States may also opt not to treat a financial undertaking as a CFC if no more than one third of its income from the above categories derives from transactions with the taxpayer or its associated enterprises.

(ii) *Option 2*: Inclusion of the non-distributed income of the entity or PE arising from non-genuine arrangements that have been put in place for the essential purpose of obtaining a tax advantage. For this purpose, an arrangement or a series of arrangements is regarded as non-genuine to the extent the entity or PE would not have owned the assets or would not have undertaken the risks that generate all, or part of, its income had it not been controlled by a company that carries out the significant people functions relevant to such assets and risks as are instrumental in generating the controlled company's income. The income to be included in the tax base of the taxpayer (in proportion to the taxpayer's participation in the entity) is limited to amounts generated through assets and risks linked to significant people functions performed by the controlling company. The attribution of CFC income must be calculated in accordance with the arm's length principle.

Member States may exclude from the scope of this provision an entity or PE with accounting profits:

- (i) Of no more than 750,000 euros and non-trading income of no more than 75,000 euros; or

- (ii) Amounting to no more than 10% of its operating costs for the tax period (for these purposes, operating costs do not include the cost of goods sold outside the country in which the entity is resident or the PE is situated for tax purposes, or payments to associated enterprises).

The income must be included in the tax base of the taxpayer in the tax period in which the tax year of the CFC ends.

To avoid double taxation, the amount previously taxed under the CFC rules must be deducted from the tax base when calculating tax due on distributed profits or the disposal of the participation in the CFC.⁶²⁰ In the same vein, the Member State of the taxpayer must allow a deduction for the tax paid by the CFC in its state of tax residence or location, the deduction being calculated in accordance with national law.⁶²¹

Member States were required to adopt and publish the laws, regulations and administrative provisions necessary to comply with the CFC rules set out in the ATAD by December 31, 2018, and to apply those provisions from January 1, 2019.

On February 26, 2026, the CJEU rendered its judgment in *Commission v. Belgium*.⁶²² The case concerned the (initial) implementation of the ATAD 1 CFC rules by Belgium where option was made for application of the Article 7(2)(b) "non-genuine arrangement" model (Option 2) (see, above). The Court held that Belgium had breached its obligations under the ATAD 1 CFC rules as it had failed to implement Article 8(7), which requires Member States to allow a taxpayer to deduct the tax paid by a CFC from the tax due in the Member State of the parent (see, above). Belgium's argument that, under Option 2, Article 8(7) did not apply or was not mandatory was rejected by the Court on the ground that Article 8(7)'s wording ("*The Member State of the taxpayer shall allow (...)*") is unequivocal, rendering the provision mandatory without leaving any discretion for the Member States. The Court added that Article 8(7) constitutes an exhaustive harmonization, meaning Member States cannot rely on Article 3 of ATAD 1 (i.e., the minimum level of protection clause pursuant to which the Directive shall not preclude the application of domestic or agreement-based provisions aimed at safeguarding a higher level of protection for domestic corporate tax bases, see VI.A., above) to justify a stricter approach. The Court added that, in the context of proportionality, a non-genuine arrangement set up mainly for tax purposes (wholly artificial arrangement) may not be subject to a higher tax burden than what would be the case absent such an arrangement and that it is sufficient, for the ATAD's aim of avoiding base erosion, that the advantage sought by the taxpayer from the arrangement is cancelled out.

6. Hybrid Mismatches

Building on OECD BEPS Action 2 (*Neutralizing the Effects of Hybrid Mismatch Arrangements*),⁶²³ ATAD 1 addresses hybrid mismatches, i.e., situations in which a cross-border ac-

⁶¹⁸ Under the Initial Proposal, the CFC rule applied if more than 50% of the income accruing to the entity fell within any of the following categories: (i) interest; (ii) royalties; (iii) dividends and income from disposal of shares; (iv) income from financial leasing; (v) income from immovable property unless the Member State of the parent would not be entitled to tax the income under a tax treaty; (vi) income from insurance, banking and other financial activities; or (vii) income from services rendered to the taxpayer or its associated enterprises; the provision applied to financial undertakings if more than 50% of the income in these categories came from transactions with the taxpayer or its associated enterprises.

⁶¹⁹ Where the CFC is resident or situated in a third country that is not party to the EEA Agreement, Member States may decide to refrain from applying this exception.

⁶²⁰ ATAD 1, Art. 8(5) and (6).

⁶²¹ ATAD 1, Art. 8(7).

⁶²² Case C-524/23, *Commission v. Belgium*.

⁶²³ See, OECD (2015), *Neutralising the Effects of Hybrid Mismatch Arrangements, Action 2 — 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, <https://doi.org/10.1787/9789264241138-en>.

tivity (whether an entity/structure or a transaction) is treated differently for tax purposes by the countries involved.⁶²⁴

Under ATAD 1, to the extent a hybrid mismatch results in a double deduction, only the Member State in which the payment concerned has its source is allowed to give the deduction. On the other hand, to the extent a hybrid mismatch results in a deduction without inclusion (see below), the Member State of the payer is to deny a deduction for the payment concerned.⁶²⁵

For these purposes, a “hybrid mismatch” refers to:

- (i) A situation involving a taxpayer in one Member State and an associated enterprise in another Member State; or
- (ii) A structured arrangement between parties in different Member States,

where differences in the legal characterization of a financial instrument or entity result in one of the following outcomes:

- (i) A deduction for the same payment, expenses or losses being given both in the Member State in which the payment has its source, the expenses are incurred, or the losses are suffered and in another Member State (“double deduction”); or
- (ii) A deduction is given for the payment in the Member State in which the payment has its source without a corresponding inclusion for tax purposes of the same payment in the other Member State (“deduction without inclusion”).⁶²⁶

Member States were to transpose the hybrid mismatch measure set out in ATAD 1 into their domestic law by December 31, 2018, at the latest, and to apply it from January 1, 2019 onwards.

The hybrid mismatch measure set out in ATAD 1 applies only in intra-EU situations and not in relation to third-countries. For example, US check-the-box situations are not targeted by the measure. For this reason, the preamble to ATAD 1 announced (the need for) the future enactment of binding rules on the tax treatment of hybrid entities in relation to third countries. This was achieved by the adoption, on May 29, 2017, of Council Directive (EU) 2017/952 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries, commonly referred to as “ATAD 2.”

According to the Preamble of ATAD 2, it is appropriate to supplement ATAD 1 with rules on hybrid mismatches with third countries (where at least one of the parties involved is a corporate taxpayer or, in the case of reverse hybrids, an entity in a Member State) and imported mismatches. Consequently:

- (i) The rules on hybrid mismatches and tax residency mismatches should apply to all taxpayers subject to corporate

tax in a Member State, including PEs (or arrangements treated as PEs) of entities resident in third countries; and

- (ii) The rules on reverse hybrid mismatches should apply to all entities treated as transparent for tax purposes by a Member State.⁶²⁷

To ensure proportionality, it is necessary to address only those cases in which there is a substantial risk that taxation will be avoided through the use of hybrid mismatches. It is, therefore, appropriate to cover the following:

- (i) Mismatches that arise between a head office and a PE;
- (ii) Mismatches between two or more PEs of the same entity;
- (iii) Hybrid mismatch arrangements between a taxpayer and its associated enterprises;
- (iv) Hybrid mismatch arrangements between associated enterprises; and
- (v) Hybrid mismatches resulting from a structured arrangement involving the taxpayer.⁶²⁸

Mismatches that specifically involve the hybridity of entities should be addressed only where one of the associated enterprises has — at a minimum — effective control over the other associated enterprise. Consequently, in those cases, it is required that an associated enterprise be held by, or hold, the taxpayer or another associated enterprise through a participation in terms of voting rights, capital ownership or entitlement to receive profits of 50% or more. The ownership, or rights of persons acting together must be aggregated for the purposes of applying this test.⁶²⁹

Article 1 of ATAD 2 replaces and amends certain definitions set forth in ATAD 1 and adds new definitions, thereby significantly expanding the scope of the initial ATAD 1 hybrid mismatch measure.

A “hybrid mismatch” within the meaning of Article 2(9) of ATAD 1, as amended by ATAD 2, henceforth refers to a situation involving a taxpayer or (with respect to Article 9 paragraph 3) an entity, where:

- (i) A payment under a financial instrument gives rise to a deduction without inclusion outcome (see further below) and:
 - (a) The payment is not included within a reasonable period of time; and
 - (b) The mismatch outcome is attributable to differences in the characterization of the instrument or the payment made under it;
- (ii) A payment to a hybrid entity⁶³⁰ gives rise to a deduction without inclusion and the mismatch outcome is the result of differences in the allocation of payments made to the hybrid entity under the laws of the jurisdiction where the

⁶²⁴ A first EU initiative targeted at hybrid mismatches, and more particularly hybrid financial instruments, may be found in the Parent-Subsidiary Directive—see the discussion at IV., above.

⁶²⁵ ATAD 1, Arts. 9(1) and 9(2), respectively. It is worth noting that the hybrid mismatch rule proposed by the Commission in the Initial Proposal would have required the residence state to adopt the characterization of the source state with respect both to hybrid instruments and to hybrid entities. This represents a departure from the recommendations set out by the OECD, which explicitly opted not to recharacterize income. Presumably, this is why the characterization requirement was eventually abandoned in ATAD 1.

⁶²⁶ ATAD 1, Art. 2(9).

⁶²⁷ ATAD 2, Preamble, Recital (8).

⁶²⁸ ATAD 2, Preamble, Recital (12).

⁶²⁹ ATAD 2, Preamble, Recital (13).

⁶³⁰ A “hybrid entity” is defined as any entity or arrangement that is regarded as a taxable entity under the laws of one jurisdiction and whose income or expenditure is treated as income or expenditure of one or more other persons under the laws of another jurisdiction.

hybrid entity is established or registered and the jurisdiction of any person with a participation in the hybrid entity;

(iii) A payment to an entity with one or more PEs gives rise to a deduction without inclusion and the mismatch outcome is the result of differences in the allocation of payments between the head office and a PE or between two or more PEs of the same entity under the laws of the jurisdictions in which the entity operates;

(iv) A payment gives rise to a deduction without inclusion as a result of a payment to a disregarded PE;⁶³¹

(v) A payment made by a hybrid entity gives rise to a deduction without inclusion and the mismatch is the result of the fact that the payment is disregarded under the laws of the payee jurisdiction;

(vi) A deemed payment between a head office and a PE or between two or more PEs gives rise to a deduction without inclusion and the mismatch is the result of the fact that the payment is disregarded under the laws of the payee jurisdiction; or

(vii) A double deduction outcome occurs.⁶³²

Further clarifications are made to the effect that:

(a) A payment representing the underlying return on a transferred financial instrument will not give rise to a hybrid mismatch under (i) where the payment is made by a financial trader under an on-market hybrid transfer,⁶³³ provided the payer jurisdiction requires the financial trader to include as income all amounts received in relation to the transferred financial instrument;

(b) A hybrid mismatch will only arise under (v), (vi) or (vii), above, to the extent the payer jurisdiction allows the deduction to be set off against an amount that is not dual-inclusion income; and

(c) A mismatch outcome will not be treated as a hybrid mismatch unless it arises between associated enterprises, between a taxpayer and an associated enterprise, between a head office and a PE, between two or more PEs of the same entity or under a structured arrangement.

“Mismatch outcome” means a “double deduction” or a “deduction without inclusion.”

A “double deduction” means a deduction of the same payment, expenses or losses in the jurisdiction in which the payment has its source, the expenses are incurred or the losses are suffered (payer jurisdiction) and in another jurisdiction (investor jurisdiction). In the case of a payment by a hybrid entity or PE, the payer jurisdiction is the jurisdiction in which the hybrid entity or PE is established or situated.

⁶³¹ A “disregarded PE” means any arrangement that is treated as giving rise to a PE under the laws of the head office jurisdiction and is not treated as giving rise to a PE under the laws of the other jurisdiction.

⁶³² ATAD 2, Art. 1(2)(b).

⁶³³ A “hybrid transfer” refers to any arrangement to transfer a financial instrument where the underlying return on the transferred financial instrument is treated for tax purposes as derived simultaneously by more than one of the parties to that arrangement; an “on-market hybrid transfer” means any hybrid transfer that is entered into by a financial trader in the ordinary course of business, and not as part of a structured arrangement.

A “deduction without inclusion” means the deduction of a payment (or deemed payment between a head office and a PE or between two or more PEs) in any jurisdiction in which that payment (or deemed payment) is treated as having been made (in the payer jurisdiction) without a corresponding inclusion for tax purposes of that payment (or deemed payment) in the payee jurisdiction.

The “payee jurisdiction” is any jurisdiction in which such a payment (or deemed payment) is received or is treated as being received under the laws of any other jurisdiction.

ATAD 2 adds the following definitions:

(i) “Consolidated group for financial accounting purposes” means a group consisting of all entities fully included in consolidated financial statements drawn up in accordance with IFRS or the national financial reporting system of a Member State; and

(ii) A “structured arrangement” means an arrangement involving a hybrid mismatch where the mismatch outcome is priced into the terms of the arrangement or an arrangement that has been designed to produce a hybrid mismatch outcome, except where the taxpayer or an associated enterprise could not reasonably have been expected to be aware of the hybrid mismatch and did not share in the value of the tax benefit resulting from the hybrid mismatch.

The following summarizes how ATAD 2 replaces the text of Article 9 of ATAD 1:

(i) To the extent a hybrid mismatch results in a “double deduction,” the deduction must be denied in the Member State that is the investor jurisdiction (new Article 9(1)(a)). Where the deduction is not denied in the investor jurisdiction, the deduction must be denied in the Member State that is the payer jurisdiction (new Article 9(1)(b)).

Nevertheless, any such deduction is eligible to be set off against dual inclusion income, whether arising in a current or subsequent period.

(ii) To the extent a hybrid mismatch results in a “deduction without inclusion,” the deduction must be denied in the Member State that is the payer jurisdiction (new Article 9(2)(a)). Where the deduction is not denied in the payer jurisdiction, the amount of the payment that would otherwise give rise to a mismatch outcome is to be included in income in the Member State that is the payee jurisdiction (new Article 9(2)(b)).

However, a Member State may exclude from the scope of:

◦ Article 9(2)(b): hybrid mismatches as defined in Article 2(9)(b), (c), (d) or (f); and

◦ Article 9(2)(a) and (b) (until December 31, 2022): hybrid mismatches resulting from a payment of interest under a financial instrument to an associated enterprise where:

(a) The financial instrument has conversion, bail-in or write down features;

(b) The financial instrument has been issued with the sole purpose of satisfying loss-absorbing capacity requirements applicable to the banking sector and

the financial instrument is recognized as such in the taxpayer's loss-absorbing capacity requirements;

(c) The financial instrument has been issued:

- In connection with financial instruments with conversion bail-in or write down features at the level of a parent undertaking;
- At a level necessary to satisfy applicable loss-absorbing capacity requirements; and
- Not as part of a structured arrangement; and

(d) The overall net deduction for the consolidated group under the arrangement does not exceed the amount that would have been deductible had the taxpayer issued the financial instrument directly on the market.

(iii) A Member State must also deny a deduction for any payment made by a taxpayer to the extent the payment directly or indirectly funds deductible expenditure giving rise to a hybrid mismatch through a transaction or series of transactions, between associated enterprises or entered into as part of a structured arrangement, except to the extent one of the jurisdictions involved in the transaction or series of transactions has made an equivalent adjustment with respect to that hybrid mismatch.

(iv) To the extent a hybrid mismatch involves disregarded PE income that is not subject to tax in the Member State in which the taxpayer is resident for tax purposes, that Member State is to require the taxpayer to include the income that would otherwise be attributed to the disregarded PE. This provision applies unless the Member State is obliged to exempt the income under a tax treaty entered into by the Member State with a third country.

(v) To the extent a hybrid transfer is designed to produce relief for tax withheld at source on a payment derived from a transferred financial instrument for more than one of the parties involved, the Member State of the taxpayer must limit the benefit of such relief in proportion to the net taxable income from the payment.

(vi) With respect to reverse hybrid mismatches, Article 9a specifies that, where one or more associated nonresident entities holding in aggregate a direct or indirect interest in 50% or more of the voting rights, capital interests or rights to a share of profit in a hybrid entity incorporated or established in a Member State, are located in a jurisdiction or jurisdictions that regard the hybrid entity as a taxable person, the hybrid entity is to be regarded as a resident of that Member State and taxed on its income to the extent such income is not otherwise taxed under the laws of the Member State or any other jurisdiction. However, this rule does not apply to:

- Collective investment vehicles;
- Investment funds; or
- Vehicles that:
 - Are widely-held;
 - Hold a diversified portfolio of securities; and

- Are subject to investor-protection regulation in the country in which they are established.

(vi) With respect to tax residence mismatches, Article 9b stipulates that, to the extent a deduction for payment, expenses or losses of a taxpayer tax resident in two or more jurisdiction, is deductible from the taxable base in both jurisdictions, the Member State of the taxpayer must deny the deduction to the extent the other jurisdiction allows the duplicate deduction to be set off against income that is not dual-inclusion income. If both jurisdictions are Member States, the Member State in which the taxpayer is not deemed to be resident under the terms of the tax treaty between the two Member States concerned is to deny the deduction.

Member States were to adopt and publish the laws, regulations and administrative provisions necessary to comply with the above measures by December 31, 2019, and to apply those provisions from January 1, 2020 onwards. However, as regards Article 9a (reverse hybrids), the applicable deadlines were December 31, 2021 and January 1, 2022, respectively.

Comment: The ATAD 2 measures are significantly more complex than the initial ATAD 1 provisions. Virtually all structures in which hybrid mismatches arise may be caught by these rules. ATAD 2 lays down principle-based rules, leaving the details of implementation to Member States. This has the potential to result in inconsistencies in implementation among Member States, possibly creating additional mismatches. Another concern is whether Member States that had already taken steps to implement the OECD BEPS Action 2 recommendations are considered to be compliant with the Directive.

7. EU Legislative Competence to Adopt the ATAD [1]

In her Opinion in *Case C-524/23, Commission v. Belgium* published on May 22, 2025, Advocate General Kokott raised doubts as to whether the adoption of the ATAD [1] is covered by the EU's legislative competences. Similar doubts have been raised in the academic literature,⁶³⁴ as well as in the reservations expressed by the Maltese and Swedish Parliament in the con-

⁶³⁴ See, for example, de Graaf, A. and Visser, K. J., ATAD Directive: Some Observations Regarding Formal Aspects, *EC Tax Review* 25 (2016), p. 199 (204); Traversa, E. and Possoz M., L'équilibre délicat entre la lutte contre l'évasion fiscale internationale et l'achèvement du marché intérieur: réflexion sur la mise en œuvre du plan BEPS de l'OCDE au sein de l'Union européenne, in: *Revue des affaires européennes* 2018, p. 611 (624 and 625); Brokelind C., The Anti-Tax Avoidance Directive under Scrutiny: A Matter of Competence?, in: Monsénégro, J. and Bjurberg, J. (Eds.), *International Taxation in a Changing Landscape — Liber Amicorum in Honour of Bertil Wiman*, Alphen aan den Rijn, 2019, p. 45 (48 and 49); Haslehner, W., The General Scope of the ATAD and its Position in the EU Legal Order, in: Haslehner, W. et al (Eds.), *A Guide to the Anti-Tax Avoidance Directive*, Cheltenham, 2020, p. 32 (38 and 39); Hey, J., Harmonisierung der Missbrauchsabwehr durch die Anti-Tax-Avoidance-Directive (ATAD), in: *Steuer und Wirtschaft* 2017, p. 248 (254, 262); Oppel, F., BEPS in Europa: (Schein-) Harmonisierung der Missbrauchsabwehr durch neue Richtlinie 2016/1164 mit Nebenwirkungen, in: *Internationales Steuerrecht* 2016, p. 797 (798 and 799).

text of the ATAD [1] legislative procedure,⁶³⁵ to which the Advocate General expressly refers.

The Advocate General's reasoning is based on the fact that the EU based the ATAD on Article 115 of the TFEU, which gives the Council the legislative competence to issue "directives for the approximation of such laws, regulations or administrative provisions of the Member States as directly affecting the establishment or functioning of the internal market." A direct effect of the establishment or functioning of the internal market could arise from a restriction on the fundamental freedoms or from an appreciable distortion of competition between the entities concerned. However, the EU legislature appears to see the effect of promoting the internal market primarily in terms of combating tax-avoidance practices.⁶³⁶ In so doing, the ATAD [1] does not remove restrictions on fundamental freedoms arising from existing national provisions. On the con-

trary, by placing Member States under an obligation to observe the uniform minimum protection of national corporate tax systems against tax avoidance practices (i.e., by imposing anti-abuse rules and income inclusion measures), it limits the ability of companies to carry on cross-border activities, thus hindering the exercise of the fundamental freedoms instead of promoting it.⁶³⁷ The Advocate General adds that, despite reservations in this regard, the instant action for failure to fulfill an obligation must leave open the question of the extent of European Union's legislative competence with respect to the ATAD.⁶³⁸ She concludes that, currently, the issue of competence can probably be clarified only by means of preliminary ruling proceedings calling into question the validity of the ATAD [1]. In this context, the author is aware of a case currently pending before the (Belgian) Bruges Court of First Instance, in which the validity of Article 4 of the ATAD [1] is challenged. The expectation is that the Bruges Court is likely to refer the case to the CJEU. See also the discussion in II.G., above.

⁶³⁵ See, European Parliament — Committee on Legal Affairs, September, 2016, Reasoned opinion of the Maltese Parliament on the proposal for a directive laying down rules against tax avoidance practices that directly affect the functioning of the internal market (COM(2016)0026 — C8-0031/2016 — 2016/0011(CNS)); European Parliament — Committee on Legal Affairs, April 25, 2016, Reasoned opinion of the Swedish Parliament (Riksdag) concerning the proposal for a Council Directive laying down rules against tax avoidance practices that directly affect the functioning of the internal market (COM(2016)0026 — C8-0031/2016 — 2016/0011(CNS)).

⁶³⁶ The Advocate General refers to Recital 2 of ATAD [1]: "(...) It is essential for the good functioning of the internal market that, as a minimum, Member States implement their commitments under BEPS and more broadly, take action to discourage tax avoidance practices and ensure fair and effective taxation in the Union in a sufficiently coherent and coordinated fashion." and recital 16 of the ATAD [1]: "a key objective of this Directive is to improve the resilience of the internal market as a whole against cross-border tax avoidance practices, (...)".

⁶³⁷ The Advocate General refers, to that effect, to: Haslehner, W., The General Scope of the ATAD and its Position in the EU Legal Order, in: Haslehner, W. et al. (Ed.), *A Guide to the Anti-Tax Avoidance Directive*, Cheltenham, 2020, p. 32 (39); de Graaf, A. and Visser, K. J., 'ATAD Directive: Some Observations Regarding Formal Aspects', *EC Tax Review* 25 (2016), p. 199 (202); Schönfeld, J. and Ellenrieder, B., 'Das Verhältnis von Primär- und Sekundärrecht — oder: Gibt es gegen Primärrecht immunisiertes Recht?', in: *Steuer und Wirtschaft* 2019, p. 253 (261 *et seq.*).

⁶³⁸ None of the parties involved in the case had alleged that the European Union lacked legislative competence, nor did any of the Member States challenge the competence of the European Union to adopt the ATAD [1] by means of an action for annulment.

VII. Pillar Two Directive

A. General

Executive Summary

This Section provides a detailed overview of the Pillar Two Directive. The Pillar Two Directive introduces a global minimum level of effective corporate taxation for large multinational groups and large-scale purely domestic groups operating in the European Union.

The rules are intended to be consistent with the Pillar Two agreement reached by the OECD/G20 Inclusive Framework (IF) on Base Erosion and Profit Shifting (BEPS) on October 8, 2021, and to follow closely the OECD Model Rules agreed by the IF. However, to make the Pillar Two rules EU law-proof, certain adjustments have proven necessary.

1. Overview

Pillar Two consists of two rules to be introduced into national domestic tax laws, and a treaty-based rule:

(i) The two domestic tax rules are the Income Inclusion Rule (IIR) and its backstop, the Under Taxed Payments Rule (UTPR), which together are known as the Global anti-Base Erosion (GloBE) rules.

(ii) The Subject to Tax Rule (STTR) is a treaty-based rule that allows source jurisdictions to impose limited source taxation on certain related-party payments that are subject to tax at less than a minimum rate — the OECD Model Rules contain provisions with respect to the GloBE Model Rules only.⁶³⁹

The general OECD Pillar Two architecture may be summarized as follows.

(i) Pillar Two applies to groups of multinational enterprises (MNEs) and large-scale domestic groups that have a combined annual group turnover of at least 750 million euros, based on consolidated financial statements. This threshold was set by the IF to ensure consistency with existing international corporate tax policies such as the rules on Country-by-Country Reporting (CbCR).

(ii) Government entities, international organizations, non-profit organizations, pension funds and investment funds that are Ultimate Parent Entities (UPEs) of an MNE Group are not subject to the GloBE Model Rules.

(iii) The IIR works by imposing a top-up tax on a parent entity with respect to the low-taxed income of group entities (referred to as “constituent entities”).

(iv) The IIR applies on a top-down basis, which means that it is applied by the entity that is at, or near, the top of the ownership chain in the MNE Group, which is normally the UPE. However, in case where the UPE does not apply the IIR, one or more intermediate parent entities (IPEs) will have to apply the IIR to their low-taxed constituent entities.

(v) The IIR is subject to a split-ownership rule for shareholdings below 80%. This means that the IIR will be applied by a partially-owned parent entity (POPE) to its controlled subsidiaries of a subset of the MNE group in priority to the UPE when the POPE is more than 20% owned by shareholders outside the MNE group.

(vi) If there are a number of POPEs in an MNE group, the IIR will be applied by the POPE closest in the chain of ownership to the low-taxed constituent entity. The UTPR acts as a backstop to the IIR and applies in situations where there is no qualifying IIR in the jurisdiction of the UPE or where a low level of taxation arises in the jurisdiction of the UPE.

(vii) The UTPR works by allocating top-up tax to a jurisdiction to the extent the low-tax income of a constituent entity is not subject to tax under an IIR. The UTPR allocates top-up tax to jurisdictions based on a two-factor formula — the carrying value of tangible assets in the jurisdiction and the number of employees in the jurisdiction.

(viii) While the global agreement aspired to having the IIR operational from January 1, 2023, the UTPR is required to be implemented one year later.

(ix) The GloBE Model Rules operate by imposing the top-up tax on a jurisdictional basis utilizing an Effective Tax Rate (ETR) test. If the ETR of an MNE group’s constituent entities computed together as one in a jurisdiction falls below the minimum tax rate of 15%, top-up tax is due with respect to each of the constituent entities in the jurisdiction to bring the ETR of that jurisdiction up to the minimum rate.

(x) The ETR for a period is computed by dividing corporate and equivalent taxes attributable to that period for that jurisdiction (known as “adjusted covered taxes”) by the adjusted income of the MNE group for the jurisdiction.

(xi) The ETR test is both a trigger for the application of the Pillar Two rules and also a measure of how much additional tax is payable by the MNE group. The GloBE Model Rules further provide for a substance carve-out based on a formula that aims to reduce the impact of Pillar Two on MNE groups in a jurisdiction where they are carrying on real economic activities.

While the Pillar Two Directive generally closely follows the OECD Model Rules, it extends its scope to large-scale purely domestic groups in an effort to ensure compliance with the fundamental freedoms, in particular the freedom of establishment (see the discussion at II.G.1.a. and II.G.2.d., above).

This means that a parent company established in an EU Member State that has a subsidiary in the same State with an effective tax rate of less than 15% would have to pay a top-

⁶³⁹ In the Pillar Two Directive, that approach is mirrored in considering that the STTR is naturally suited to being addressed in bilateral tax treaties, implying that the Pillar Two Directive is merely aimed at implementing the GloBE Model Rules. As indicated, the Pillar Two Directive has been designed to reflect the global OECD Pillar Two agreement, albeit with some necessary adjustments to ensure conformity with EU law.

up tax. In addition, the Pillar Two Directive makes use of an option offered in the Commentary on the OECD Model Rules whereby the Member State of a constituent entity applying the IIR, which is usually the jurisdiction of the UPE, is required to ensure effective taxation at the minimum agreed level not only of foreign subsidiaries but also of all constituent entities resident in that Member State and permanent establishments (PEs) of an MNE group established in that Member State.

The OECD Model Rules provide that the jurisdiction that applies the IIR takes into account the ETR of only foreign constituent entities.

2. Interaction *With* Other EU Tax Initiatives

In the Explanatory Memorandum accompanying the Proposed Pillar Two Directive, the Commission points out that the implementation of the GloBE Model Rules in the European Union could have implications for existing provisions of the Anti-Tax Avoidance Directive (ATAD) legislation and specifically for the Controlled Foreign Company (CFC) rules (see, VI.B.5., above) which could interact with the primary rule of Pillar Two, i.e., the IIR. The Commission explored how best to accommodate the interaction between the ATAD CFC rules and the IIR and concluded that it was not necessary to amend the ATAD in this regard. Moreover, according to the Commission, it is consistent with the OECD Model Rules to continue the application of the ATAD CFC rules in parallel with the GloBE Model Rules. In practice, the ATAD CFC rules will apply first and any additional taxes paid by a parent company under a CFC regime in a given fiscal year will be taken into consideration in the GloBE Model Rules by attributing them to the relevant low-taxed entity for purposes of computing its jurisdictional effective tax rate.

Secondly, according to the Commission, the transposition of the GloBE Model Rules in the European Union should pave the way for agreeing the pending proposal for recasting the Interest and Royalties Directive, which has been in the Council since 2011 (see the discussion at V.E., above — however note that as of February 2025 the Commission has now suggested that this is unnecessary). The aim of the recast was to make the benefits of the Interest and Royalties Directive (which eliminates withholding tax obstacles to cross-border interest and royalty payments within a group of companies) conditional on the interest or royalties being subject to tax in the destination state. Some Member States held the view that the Interest and Royalties Directive should go further and set a minimum level of tax in the destination state as a condition for benefiting from the absence of withholding tax. In the Commission's opinion, the implementation of the GloBE Model Rules in the European Union should resolve the issue under discussion for recasting the Interest and Royalties Directive.

3. Background and Development

Building on the Communication from the Commission to the European Parliament and the Council Business Taxation for the 21st Century presented on May 18, 2021,⁶⁴⁰ the Commission on December 22, 2021 launched a proposal for a Council

Directive on ensuring a global minimum level of taxation for multinational groups in the European Union (the “Proposed Pillar Two Directive”).⁶⁴¹ Almost a full year later,⁶⁴² the Proposed Pillar Two Directive was formally adopted as Council Directive (EU) 2022/2523 on ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups in the Union (the “Pillar Two Directive”).⁶⁴³

The objective of the Pillar Two Directive is to provide a common framework for implementing the OECD Model Rules into EU Member States' national laws in a coordinated manner and adjusted for EU law requirements. Specifically, the Pillar Two Directive aims to lay down rules to ensure a minimum level of effective corporate taxation of large multinational groups and large-scale purely domestic groups operating in the Single Market. The rules are intended to be consistent with the Pillar

⁶⁴¹ {SWD (2021) 580 final}; COM (2021) 823 final; 2021/0433 (CNS).

⁶⁴² At the ECOFIN meeting of January 18, 2022, the EU Finance Ministers held a public policy debate on the Proposed Pillar Two Directive. Overall, EU Member States expressed their support and confirmed the priority nature of this initiative and the urgent need to transpose the agreed rules of international corporate taxation as soon as possible. However, eight Member States also expressed concerns related to the tight implementation timeline, the complexity of the rules, the link between Pillar One and Pillar Two and the application of the rules to domestic groups. In response to these concerns a restated version of the Proposed Pillar Two Directive was presented on March 12, 2022, in anticipation of the March 15, 2022 ECOFIN meeting. At the March 15, 2022 ECOFIN meeting, four EU Member States (Estonia, Malta, Poland and Sweden) still expressed some reservations and did not agree with the adoption of the “compromise” version of the Proposed Pillar Two Directive, with the result that the required unanimous consent for its adoption was not achieved. A new compromise text of the Proposed Pillar Two Directive was presented on March 28, 2022, with a view to removing these reservations. At the April 5, 2022, ECOFIN meeting, it was still not possible to reach a consensus. Poland reserved its position on the grounds that the new compromise version of the Proposed Pillar Two Directive did not constitute “a legally binding solution” for ensuring that both Pillar One and Pillar Two enter into force at a similar point in time. The French presidency of ECOFIN responded that such a legal link would not be possible as EU law did not allow making the Pillar Two Directive contingent on the entry into force of the (contemplated) multilateral convention implementing Pillar One — an international instrument — since this would undermine European sovereignty. At the ECOFIN meeting of June 17, 2022, held by way of public session, Poland dropped its reservations on the adoption of the Pillar Two Directive. Hungary, however, while it had supported the Directive in the April 5, 2022 ECOFIN meeting, changed its position and formally objected on the grounds that Europe is currently facing major challenges as a result of the ongoing war in the region and the current economic crisis (for example, increasing interest rates and inflation), adding that required technical work on Pillar Two is still ongoing. In other words, again no unanimity could be reached. On September 9, 2022, the French, German, Italian, Dutch and Spanish governments confirmed their intention to implement a global minimum tax (Pillar Two) in 2023 thereby hinting at a potential use of the “enhanced cooperation procedure” in TFEU, Art. 20, which would allow the 26 participating Member States to proceed, without the need for the approval of the last dissenting Member State. In an attempt to convince Hungary to drop its reservations, the EU Council published a slightly revised draft of the Pillar Two Proposal on November 25, 2022. Incidentally, the revised version included only editorial changes following a legal-linguistic review by the EU institutions, as opposed to the previous compromise text of June 21, 2022. Eventually, on December 12, 2022, as part of a more “global package,” the Council announced it had reached unanimity to adopt Pillar Two at the EU level. As indicated, formal adoption of the Pillar Two Directive followed on December 14, 2022.

⁶⁴³ EU Official Journal of December 22, 2022, L 328/1. As regards Pillar One, to ensure consistent implementation in all EU Member States, the Commission will reportedly propose a directive for the implementation of Pillar One in the EU “as soon as the work at the OECD is sufficiently mature”. However, the question as to whether a Pillar One directive might actually be needed is still open as, depending on the final format of the OECD agreement for that Pillar, it might well be directly binding for the signing countries of the OECD Mutual Convention to implement Pillar One (MLC) anyway.

⁶⁴⁰ https://taxation-customs.ec.europa.eu/system/files/2021-05/communication_on_business_taxation_for_the_21st_century.pdf.

Two agreement reached by the OECD/G20 Inclusive Framework (IF) on Base Erosion and Profit Shifting (BEPS) on October 8, 2021, and to follow closely the OECD Model Rules agreed by the IF and published on December 20, 2021.

By way of a reminder, within the context of an extension to the 2015 OECD BEPS project, the IF worked on a solution to address the tax challenges arising from the digitalization of the economy. The discussions focused on two work streams:

- (i) Pillar One, which proposes a partial re-allocation of taxing rights towards market jurisdictions; and
- (ii) Pillar Two, which proposes to introduce minimum effective taxation for large multinational groups.

Pillar Two has now been implemented via the Pillar Two Directive as discussed in this section, whilst Pillar One is still under further discussion and development.

There is challenge to the Pillar Two project globally, as the United States has yet to adopt the rules and, on January 20, 2025, President Trump went further and issued an executive order, The Organization for Economic Co-operation and Development (OECD) Global Tax Deal (Global Tax Deal), withdrawing the United States from the OECD Two Pillars project and asking the OECD to be notified that “any commitments made by the prior [Biden] administration on behalf of the United States with respect to the Global Tax Deal have no force or effect within the United States absent an act by the Congress adopting the relevant provisions of the Global Tax Deal”. See the discussion at VII.P., below.

B. Scope

The scope of the Pillar Two Directive is defined by reference to constituent entities located in the European Union that are part of MNE groups or large-scale domestic groups (whose members are Constituent Entities) with a consolidated group revenue of at least 750 million euros in at least two of the four preceding years.

For various policy reasons, such as the desire to preserve the tax neutrality principle, and in line with the OECD Model Rules, the following entities are excluded from the scope of the Pillar Two Directive:

- (i) Governmental entities,
- (ii) International organizations,
- (iii) Non-profit organizations,
- (iv) Pension funds;
- (v) Investment entities and real estate investment vehicles (provided they are at the top of the group structure); and
- (vi) Entities owned at least 95% by excluded entities.

As regards the location of a constituent entity, the Pillar Two Directive deems a constituent entity, other than a PE or flow-through entity, to be located in the jurisdiction of which it is considered to be a resident for tax purposes. Where the location of a constituent entity cannot be ascertained based on this rule, the entity is deemed to be located in the jurisdiction in which it was created. The Pillar Two Directive also determines the location of a constituent entity that is a PE and includes tie-breaker clauses for specific situations.

In *Fugro v. Council*,⁶⁴⁴ the Dutch company, Fugro N.V., had requested to partially nullify the Pillar Two Directive because income obtained from a shipping activity covered by the Dutch tonnage tax regime — authorized by the Commission as compatible with the EU State aid rules — is not included in the international shipping income exclusion of Article 17 of the Directive. The Court, extensively referring to its holding in Joined Cases C-408/15 P and C-409/15 P, *Ackermann Saatzucht and Others v. Parliament and Council*, found that Fugro was affected only in its objective capacity as a parent entity in the maritime sector, not as an individually concerned party. In other words, the Court did not rule on the merits of the case itself as it held Fugro to lack legal standing to bring an action for annulment under Article 263 of the TFEU (see II.G.1.a.(1), above).

C. Application of the Income Inclusion Rule and the Under-Taxed Payments Rule

Chapter II of the Pillar Two Directive sets out the rules for the application of the IIR and the UTPR by EU Member States.

1. Income Inclusion Rule

Under the Pillar Two Directive, the IIR applies in the following situations:

(i) **UPE in the European Union:** if the UPE is located in the European Union, it will be subject to the top-up tax with respect to its low-taxed constituent entities in the same and other EU Member States, as well as in third country jurisdictions.

(ii) **IPE/POPE in the European Union with UPE outside the European Union:** if there is no UPE in the European Union, the low-taxed constituent entities of the MNE group in the European Union would effectively be taken into account by the third-country UPE of the group if it applies the IIR. However, if there is at least one POPE or one IPE (if the jurisdiction where the UPE is located does not apply an IIR) in the European Union, then the IPE/POPE will be subject to the top-up tax with respect to its low-taxed directly- or indirectly-owned constituent entities in the European Union and third country jurisdictions.

(iii) **POPE in the European Union with UPE in the European Union:** although a UPE located in the European Union is normally charged the top-up tax with respect to its low-taxed constituent entities (see (i)), there is also a possibility that the primary taxing right may lie with the Member State of a POPE. In these cases, a “bottom-up” method must be followed to identify the POPE that is liable to tax. It is necessary to start from the lowest-tier wholly-owned constituent entities and move up to the first POPE, which will be liable to top-up tax under the IIR with respect to its low-taxed constituent entities. The other POPEs up to the UPE will also be subject to the IIR but with a right to receive a credit for top-up tax payable by another POPE lower in the chain.

The Pillar Two Directive determines how much of a constituent entity’s top-up tax a parent entity is entitled to collect through the IIR. This allocable share is, in general, based on

⁶⁴⁴ Case C-146/24 P, *Fugro v Council*.

the proportion of the parent entity's interest in the income of the low-taxed constituent entity. Furthermore, in the case of a large-scale domestic group, a UPE located in an EU Member State is subject to the IIR top-up tax with respect to its low-taxed constituent entities.

To preserve the sovereignty of EU Member States, the Pillar Two Directive provides that a Member State can opt to apply the top-up tax domestically to constituent entities located in its territory (domestic top-up tax). This election allows the top-up tax to be charged and collected in a jurisdiction in which a low-level of taxation occurred, instead of all the additional tax being collected at the level of the UPE. When the election is exercised, the parent entity applying the IIR will be obliged to give credit for the qualified domestic top-up tax in calculating the top-up tax with respect to the relevant jurisdiction.

2. *Undertaxed Payments Rule*

The Pillar Two Directive provides that in circumstances where the UPE is located outside the European Union in a jurisdiction that does not apply a qualifying IIR, all its constituent entities in jurisdictions with an appropriate UTPR framework will be subject to the UTPR.

In this circumstance, an apportionment will be made among the constituent entities of such an MNE group that are located in an EU Member State, and those entities will have to pay, in their respective Member States, a share of the top-up tax linked to the low-taxed subsidiaries in the MNE group.

The Pillar Two Directive further provides that the UTPR will also apply to situations in which the jurisdiction of the UPE operates a qualifying IIR but the UPE, together with its subsidiaries located in that same jurisdiction, are low-taxed. The top-up tax corresponding to the low-taxed UPE and its domestic subsidiaries will be charged through the UTPR to all the eligible entities across the MNE Group, including to entities that are located in an EU Member State. This should only happen when the UPE is located outside the European Union because an EU-located UPE either applies the IIR principles to itself and to its domestic subsidiaries or acknowledges that top-up was locally charged via the domestic top-up tax. No top-up tax should therefore be allocated under the UTPR when the UPE is located in the European Union.

In line with the OECD Model Rules, the calculation and allocation of the UTPR top-up tax in the Pillar Two Directive is based on two factors — the number of employees and the carrying value of tangible assets.

See also the discussion of the American Free Enterprise Chamber of Commerce (AFECC) ruling request at II.G.1.b.(1), above.

D. *Calculation of the Qualifying Income or Loss*

Chapter III of the Pillar Two Directive contains rules for determining “qualifying income,” i.e., the adjusted income that is to be taken into account for purposes of computing the effective tax rate. The starting point for the computation of this income is the financial accounting net income or loss of the constituent entity for the fiscal year, as determined for purposes of preparing consolidated financial statements.

Certain adjustments are then to be made to the financial accounting net income or loss of a constituent entity to determine its qualifying income or loss — these adjustments include adjustments for:

- (i) Net taxes expenses;
- (ii) Excluded dividends;
- (iii) Excluded equity gains or losses;
- (iv) Included revaluation method gains or losses;
- (v) Certain excluded gains or losses from the disposal of assets and liabilities;
- (vi) Asymmetric foreign currency gains and losses;
- (vii) Policy disallowed expenses;
- (viii) Prior period errors and changes in accounting principles; and
- (ix) Accrued pension expenses (all as defined in Article 16(1) of the Pillar Two Directive).

In line with the OECD Model Rules, the Pillar Two Directive excludes international shipping income and partly ancillary international shipping income from the application of the GloBE Model Rules. This exclusion follows the principle in accordance with which, in national tax systems, income from shipping is often taxed under a set of rules separate from those of the mainstream corporate tax system.

Chapter III of the Pillar Two Directive also includes rules specific to constituent entities that are PEs or flow-through entities.

E. *Computation of Adjusted Covered Taxes*

Chapter IV of the Pillar Two Directive defines “covered taxes of a constituent entity.”

These include:

- (i) Taxes accrued in the financial accounts of a constituent entity with respect to its income or profits, or its share of the income or profits of a constituent entity in which it holds an ownership interest;
- (ii) Taxes on distributed profits, deemed profit distributions and non-business expenses imposed under an eligible distribution tax system;
- (iii) Taxes imposed in lieu of a generally applicable corporate income tax; and
- (iv) Taxes levied by reference to retained earnings and corporate equity, including taxes on multiple components based on income and equity.

“Covered taxes of a constituent entity” do not include:

- (i) The top-up tax accrued by a parent entity under a qualified income inclusion rule;
- (ii) The top-up tax accrued by a constituent entity under a qualified domestic top-up tax;

(iii) Taxes attributable to an adjustment made by a constituent entity as a result of the application of a qualified UTPR;

(iv) Disqualified refundable imputation tax; and

(v) Taxes paid by an insurance company with respect to returns to policyholders.

At the option of a constituent entity, covered taxes with respect to any net gain or loss arising from the disposal of immovable property in the fiscal year in which the election is made are to be excluded from the computation of the adjusted covered taxes.

Chapter IV subsequently outlines the rules for the calculation of “adjusted covered taxes” of a constituent entity for a fiscal year. The main principle in allocating covered taxes is to assign them to the jurisdiction in which the underlying profits subject to these taxes were earned. To ensure adherence to this principle, the Pillar Two Directive also provides special rules with respect to cross-border taxes on income streams in the case of a PE, transparent entity, controlled foreign company or hybrid entity, and taxes on dividends.

F. Calculation of the Effective Tax Rate and the Top-Up Tax

Chapter V of the Pillar Two Directive contains rules for the calculation of the effective tax rate of an MNE group in a jurisdiction for a fiscal year. The effective tax rate is computed by dividing the adjusted covered taxes of the group by the adjusted income earned by the group in a specific jurisdiction for the fiscal year. In line with the global OECD agreement, the minimum effective tax rate for purposes of the GloBE Model Rules is set at 15%. In other words, if the effective tax rate for the entities in a particular jurisdiction is below the 15% minimum, the Pillar Two rules are triggered and the group must pay a top-up tax to bring the rate up to 15%. This top-up tax applies irrespective of whether the subsidiary is located in a country that has signed up to the international OECD/G20 agreement.

Chapter V also deals with the calculation and allocation of the top-up tax. First, the top-up tax percentage is computed for a jurisdiction as the difference between the minimum effective tax rate of 15% and the ETR for the jurisdiction. This top-up tax percentage is then multiplied by the income for the GloBE purposes for that jurisdiction for the year in question.

In line with the GloBE Model Rules, the Pillar Two Directive provides for a substance-based income exclusion based on payroll costs and tangible assets. The filing entity of an MNE group can elect not to apply the substance-based income exclusion for a jurisdiction. The amount to be excluded under the substance-based income exclusion (if any) is deducted from the amount of income for GloBE purposes for the jurisdiction concerned in arriving at the jurisdictional top-up tax.

Finally, the top-up tax for each constituent entity in a jurisdiction is obtained by apportioning the jurisdictional top-up tax among the constituent entities in that jurisdiction based on the income for GloBE purposes of each constituent entity in that jurisdiction.

The Pillar Two Directive further specifies that when, as a result of an adjustment made to covered taxes or qualifying income or loss for a prior fiscal year, there is additional top-up

tax to be collected, such top-up tax should be treated as additional top-up tax for the fiscal year under review.

To reduce compliance burdens in low-risk situations, an exclusion applies to minimal amounts of profit, i.e., the *de minimis* income exclusion. This applies when the profits of an MNE group’s constituent entities in a jurisdiction are less than one million euros and revenues are less than 10 million euros. In such circumstances and provided an election for the *de minimis* income exclusion is made, the top-up tax of the constituent entities in this jurisdiction is deemed to be zero for GloBE purposes.

G. Special Rules for Mergers and Acquisitions

Chapter VI of the Pillar Two Directive contains special rules with respect to mergers, acquisitions, joint ventures and multi-parented MNE groups. It provides for the application of a consolidated revenue threshold to group members in a merger or demerger situation. When a constituent entity is acquired or sold by an MNE group within the scope of the rules, the entity should be treated as part of both the selling and the acquiring group during the year, with certain adjustments being made to the values of the attributes used for the operation of the GloBE Model Rules (covered taxes, eligible payroll, eligible tangible assets, GloBE deferred tax assets).

There are rules for the recognition of a gain or loss, and carrying values in a transfer of assets and liabilities, including a reorganization. There is also a special provision to include joint ventures that would otherwise not be included in the definition of an MNE group for GloBE purposes. Finally, there is a specific rule for multi-parented MNE groups to the effect that group entities are treated as part of a single MNE group.

H. Tax Neutrality and Distribution Regimes

Chapter VII of the Pillar Two Directive contains rules with respect to tax neutrality regimes and distribution tax systems.

With a view to avoiding unintended outcomes, such as a disproportionate UTPR top-up tax liability in an MNE Group, special rules apply for the computation of the income of a UPE, where the UPE is a flow-through entity or an entity subject to a deductible dividend regime.

With respect to investment entities, there are specific rules for the determination of the ETR and the top-up tax. An election to treat such entities as tax transparent entities is available, as is an election to apply the taxable distribution method.

In relation to distribution-based corporate tax systems (i.e., systems under which the taxation of profits is postponed until the profits are distributed by way of dividends or otherwise) the Pillar Two Directive provides that, on an annual election being made by the filing entity with respect to constituent entities that are subject to an eligible distribution tax system, a deemed distribution tax is included in the calculation of the adjusted covered taxes of the relevant constituent entities. This involves maintaining a deemed distribution tax recapture account for each fiscal year for which the election is made. If, in a four-year period, no tax is paid at the minimum rate on deemed distributions, and the constituent entity has not incurred an allowable loss, the top-up tax is payable based on the outstanding balance of the recapture account for the year in question.

I. Administrative Provisions

Chapter VIII of the Pillar Two Directive contains administrative provisions, including provisions addressing filing obligations.

The Two Directive obliges a constituent entity of an MNE group located in an EU Member State to file a top-up tax information return, unless the return is filed by the MNE group in another jurisdiction with which the Member State has an exchange of information agreement. The required return may be filed by either the constituent entity or another designated local entity located in the Member State on its behalf. A constituent entity that is relieved of having to file the return must nevertheless notify its tax administration of the identity and location of the constituent entity filing the return for the MNE group. The return must be filed within 15 months after the end of the fiscal year to which it relates.

Penalties apply for failure on the part of an MNE group to comply with the obligations set out above. A constituent entity that does not comply with the requirement to file a top-up tax information return for a tax year within the prescribed deadline or makes a false declaration would be charged an administrative pecuniary penalty amounting to 5 % of its turnover in the relevant fiscal year. This penalty would apply only after the constituent entity had not provided the top-up tax information return, following any issue of a reminder, within a period of six months.

J. Specific Application of the Income Inclusion Rule to Large-Scale Domestic Groups

Chapter X of the Pillar Two Directive extends the application of the IIR to purely domestic groups located in an EU Member State if they meet the 750 million euro threshold. This particular aspect of the EU rules is designed to avoid any risk of discrimination in a Member State between an entity that belongs to a group with cross-border activities and a group with purely domestic activities. These large-scale domestic groups will calculate their ETR and, where relevant, be charged any top-up tax due under the IIR.

To maintain equal treatment with regard to MNE groups that are in the first stages of their international activities, Chapter X also grants large-scale domestic groups a five-year transitional period during which their low-taxed domestic activities will be excluded from the application of the rules.

K. Assessment of Third Country Income Inclusion Rule Systems

Chapter X of the Pillar Two Directive sets out conditions that will enable the Commission to assess whether third country systems (for example, the US Corporate Alternative Minimum Tax (CAMT) or Global Intangible Low-Taxed Income (GILTI) regimes⁶⁴⁵) are equivalent to the content of the OECD GloBE

⁶⁴⁵ The US Inflation Reduction Act of 2022 (P.L. 117-169) imposes a corporate alternative minimum tax (CAMT) of 15% on the adjusted financial statement income of large corporations. Corporations would pay the larger of the minimum tax or the regular tax, which is imposed at a 21% rate and includes any additional tax from the base erosion and anti-abuse tax (BEAT). This new CAMT would apply to taxable years beginning after December 31, 2022. The CAMT is different from the 15% Pillar Two GloBE tax. The CAMT

Model Rules (and in particular to the IIR) and to include the jurisdictions that fulfil the relevant conditions in a list annexed to the Directive. This is important because whether a jurisdiction has a “qualifying IIR” plays a key role in determining how the “top-up tax” is allocated under the IIR or the UTPR. The Pillar Two Directive also assigns to the Commission the function of modifying the annexed list as a result of a subsequent assessment after a third country jurisdiction modifies its legal framework. Amendment of the Annex will have to be carried out in conformity with the rules on delegated acts.⁶⁴⁶

L. Qualified Domestic Minimum Top-Up Tax

The Pillar Two Directive offers Member States an option to introduce a Qualified Domestic Minimum Top-up Tax (QDMTT). A QDMTT is a minimum tax that is incorporated into the domestic law of a jurisdiction. Profits must be computed and any top-up tax due calculated in the same way as under the Pillar Two rules. To ensure a level playing field, a QDMTT must be implemented and administered in a way that is consistent with the OECD GloBE Model Rules, the related commentary, the administrative guidelines and the Pillar Two Directive, with no collateral or other benefits.

Once a domestic minimum tax meets the QDMTT requirements, any QDMTT paid by an entity will be fully creditable against any liability under the OECD GloBE Rules. This means that a QDMTT effectively changes the order in which jurisdictions are entitled to charge top-up taxes where the effective tax rate of an entity within Pillar Two falls below the 15% global minimum rate. The QDMTT is prioritized with the result that a jurisdiction with a QDMTT becomes the first in line to receive any top-up revenue from entities located in its jurisdiction. Without a QDMTT, that revenue would go to another country as determined by the Pillar Two rule order.

M. Transposition and Application

Member States were to bring into force the laws, regulations and administrative provisions necessary to comply with the Pillar Two Directive by December 31, 2023.⁶⁴⁷ The beginning of the application of the Pillar Two Directive rules is set for December 31, 2023, with the exception of the UTPR the application of which is deferred until December 31, 2024.

Member States in which no more than twelve ultimate parent entities of groups within the scope of the Pillar Two Directive are located may elect not to apply the IIR and the UTPR for six consecutive fiscal years beginning from December

imposes a minimum tax on worldwide income, whereas GloBE imposes a minimum tax in each country. The tax base is different in numerous ways as well. Other US minimum taxes currently in force—the tax on global intangible low taxed income (GILTI) and BEAT—also are not imposed on a per country basis. It is unclear how these taxes are to interact with GloBE, allowing foreign countries to tax the income of US multinationals whose effective tax rates are below 15%. For more information about GILTI, see 6215 T.M., Global Intangible Low-Taxed Income (GILTI).

⁶⁴⁶ A “delegated act” gives the Commission the power to adopt the technical, non-essential elements of existing legislation.

⁶⁴⁷ As part of the October 2024 infringements package, on October 3, 2024, the Commission referred Cyprus, Poland, Portugal and Spain to the CJEU for failing to notify measures transposing the Pillar Two Directive into national law. On March 12, 2025, the EU Commission suspended these court proceedings after all four Member States caught up with implementation of global minimum tax rules.

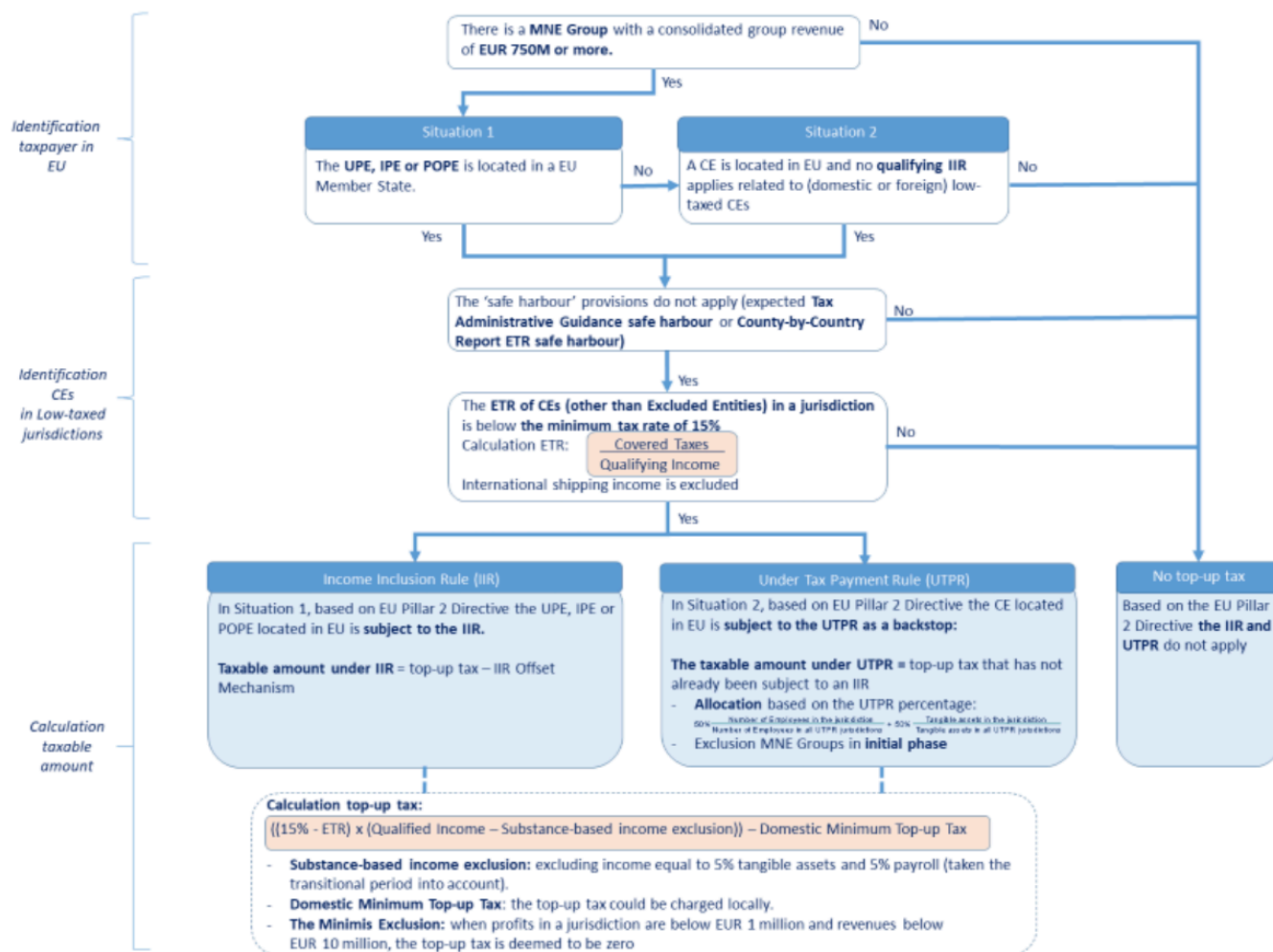
31, 2023. Member States that make such an election were to notify the Commission to that effect by December 31, 2023.⁶⁴⁸ Where the ultimate parent entity of an MNE group is located in a Member State that has made the election, the Member States, other than that in which the UPE is located, are to ensure that the constituent entities of the MNE group are subject, in the Member State in which they are located, to the UTPR top-up

⁶⁴⁸ Estonia, Latvia, Lithuania, Malta and Slovakia have postponed the application of the IIR and UTPR on this basis. These Member States are still required, however, to implement and apply all other provisions of the Pillar Two Directive to ensure consistent application across jurisdictions and among taxpayers.

tax amount allocated to such Member State for fiscal years beginning after December 31, 2023.

On December 22, 2023, the Commission updated its webpage on the Pillar Two Directive, adding various documents, including a frequently asked questions (FAQ) document. The Commission clarifies on its webpage that this document reflects the Commission Services' perspectives and is non-binding for both the Commission and the Member States.

N. Flow Chart



Source: Proposal for a COUNCIL DIRECTIVE on ensuring a global minimum level of taxation for multinational groups in the Union (COM/2021/823 final)

O. DAC 9

On October 28, 2024, the EU Commission adopted a proposal, commonly referred to as the DAC 9 proposal, to provide a framework for the operational implementation of Article 44 of the Pillar Two Directive and to enable in-scope MNEs and large-scale domestic groups to utilize the central filing mechanism for their Top-Up Tax Information Return (TTIR) using a standard template that includes information essential for tax administrations to evaluate tax risks and liabilities.

On April 14, 2025, the EU Council formally adopted the DAC 9 proposal. See the discussion at XXI.J., below.

P. OECD "Side-by-Side" Agreement

1. Background

On January 20, 2025, US President Trump issued an executive order, "The Organization for Economic Co-operation and Development (OECD) Global Tax Deal (Global Tax Deal)", which withdrew the United States from the OECD Two Pillars project and asked the OECD to be notified that "any commitments made by the prior [Biden] administration on behalf of the United States with respect to the Global Tax Deal have no force

or effect within the United States absent an act by the Congress adopting the relevant provisions of the Global Tax Deal.”

The executive order also states that the US Secretary of the Treasury is to investigate whether any foreign countries are non-compliant with their obligations under their tax treaties with the United States, or have any tax rules in place, or are likely to put tax rules in place, that are extraterritorial or disproportionately affect US citizens or corporations. If the Treasury Secretary’s investigation determines that a foreign country is imposing discriminatory or extraterritorial taxes on US citizens or corporations, Section 891 of the Internal Revenue Code (IRC) provides for the President to double the tax rate on certain US-source income received by that country’s citizens and corporations. The increased tax rate applies to income effectively connected with a US trade or business of such individuals and corporations (including compensation from personal services performed in the United States), and income from sources within the United States not effectively connected with a US trade or business (such as dividends, interest, rents, royalties and certain capital gains). The increased tax cannot exceed 80% of the taxpayer’s income. If the foreign country removes the unfair taxes, the President can revoke the doubled tax rates. It is not clear how Section 891 would interact with existing US income tax treaties.

In addition, on January 22, 2025, the US House of Representatives’ Ways and Means Committee Chairman Jason Smith (R-MO) introduced House Resolution 591, the *Defending American Jobs and Investment Act* (H.R. 591, 118th Cong. (2025)).⁶⁴⁹ By adding Section 899 to the IRC, the bill would enact additional measures to counter discriminatory or extraterritorial taxes. Specifically, it would impose a 5% addition to the US tax rate each year for four years on income taxable under US law derived by an individual or entity located in a foreign jurisdiction that has been identified by the Treasury Department as imposing a discriminatory or an extraterritorial tax. After four years, the cumulative 20% additional tax would be imposed each year the targeted tax remains in effect. The additional tax rate would apply to any individual (other than a citizen or resident of the United States) who is a citizen of such a foreign jurisdiction and any corporation created or organized in such a foreign jurisdiction. Such an individual or entity would also be denied the benefit of reduced withholding taxes under any treaty obligation of the United States. The additional tax rate would cease to apply after a foreign country repealed its extraterritorial and discriminatory taxes.

2. G7 Side-by-Side Agreement

On June 26, 2025, US Treasury Secretary Scott Bessent announced that an agreement had been reached with the G7 countries (Canada, France, Germany, Italy, Japan and the United Kingdom) to exclude US companies from Pillar Two (the so-called “G7 Side-by-Side Agreement”).

The G7 Side-by-Side Agreement envisioned a “side-by-side” approach under which:

(i) US anti-avoidance rules (e.g., the Global Intangible Low-Taxed Income (GILTI) regime,⁶⁵⁰ now formally designated as the Net CFC Tested Income (NCTI) regime under the July 4, 2025 One Big Beautiful Bill Act (OBBBA)) are deemed to be equivalent to the content of the OECD GloBE Model Rules (and in particular to the IIR); and

(ii) US-parented groups are exempt from both the IIR and the UTPR. Under the agreement, the exemption from the IIR and the UTPR would apply provided three criteria are satisfied, i.e.: (a) a minimum rate (yet to be decided) is applied to both domestic and foreign income earned; (b) a CFC regime is in place under which undistributed profits are subject to a minimum rate of taxation (yet to be decided); and (c) a foreign tax credit or “equivalent relief” for QDMTTs is made available.

A crucial component of the G7 Side-by-Side Agreement was that the United States had to remove proposed Section 899. This was effectively done by dropping the provision from the final version of the OBBBA.

While endorsed by the G7, the “side-by-side” approach needed to be further translated into guidance from the OECD.

3. OECD Side-by-Side Package

On January 5, 2026, the so-called Side-by-Side package (hereinafter, the SbS Package) was included in the GloBE IF’s Administrative Guidance,⁶⁵¹ which guidance will be incorporated into the OECD GloBE Model Rules in due course.

The SbS Package encompasses the following components:

(i) Side-by-Side System, comprising the Side-by-Side (or SbS) Safe Harbor and the UPE Safe Harbor;

(ii) Simplification measures: Simplified ETR Safe Harbor and extension of the Transitional Country-by-Country Reporting (CbCR) Safe Harbor (not further discussed here); and

(iii) Substance-based Tax Incentive Safe Harbor (not further discussed here).

⁶⁵⁰ The US Inflation Reduction Act of 2022 (P.L. 117-169) imposes a corporate alternative minimum tax (CAMT) of 15% on the adjusted financial statement income of large corporations. Corporations would pay the larger of the minimum tax or the regular tax, which is imposed at a 21% rate and includes any additional tax from the base erosion and anti-abuse tax (BEAT). This new CAMT would apply to taxable years beginning after December 31, 2022. The CAMT is different from the 15% Pillar Two GloBE tax. The CAMT imposes a minimum tax on worldwide income, whereas GloBE imposes a minimum tax in each country. The tax base is different in numerous ways as well. Other US minimum taxes currently in force—the tax on global intangible low taxed income (GILTI) and BEAT — also are not imposed on a per country basis. It is unclear how these taxes are to interact with GloBE, allowing foreign countries to tax the income of US multinationals whose effective tax rates are below 15%. For more information about GILTI, see 6215 T.M., Global Intangible Low-Taxed Income (GILTI).

⁶⁵¹ OECD (2026), Tax Challenges Arising from the Digitalisation of the Economy — Global Anti-Base Erosion Model Rules (Pillar Two), Side-by-Side Package: Inclusive Framework on BEPS, OECD, <https://www.oecd.org/content/dam/oecd/en/topics/policy-sub-issues/global-minimum-tax/side-by-side-package.pdf> (hereinafter referred to as the “SbS Administrative Guidance”).

⁶⁴⁹ See, “Ways and Means Republicans Introduce Legislation to Reinforce Trump Administration’s Rejection of Biden Global Tax Surrender — Ways and Means” (January 22, 2025): <https://waysandmeans.house.gov/2025/01/22/ways-and-means-republicans-introduce-legislation-to-reinforce-trump-administrations-rejection-of-biden-global-tax-surrender/>.

4. Side-by-Side System: Summary Overview

Under the Side-by-Side system, the IF has agreed to the SbS and UPE Safe Harbors that apply to MNE Groups headquartered in jurisdictions which the IF has determined meet the requirements for an eligible tax regime. The key elements of the system are as follows:⁶⁵²

a. SbS Safe Harbor

The SbS Safe Harbor provides a mechanism for recognizing cases when an MNE Group is headquartered in a jurisdiction with a tax system that imposes minimum tax requirements with respect to domestic and foreign income. At the election of the Filing Constituent Entity, the Top-up Tax for a jurisdiction for a Fiscal Year will be deemed to be zero for purposes of the IIR and the UTPR where the Constituent Entities located in the jurisdiction are eligible for the SbS Safe Harbor. The Constituent Entities of an MNE Group are eligible for the SbS Safe Harbor for a Fiscal Year if the UPE of that MNE Group is located in a jurisdiction with a Qualified SbS Regime for the Fiscal Year.

A jurisdiction has a Qualified SbS Regime if it: (a) has an eligible domestic tax system; (b) has an eligible worldwide tax system; (c) provides a foreign tax credit for QDMTTs on the same terms as any other creditable Covered Tax; and (d) enacted its eligible domestic tax system and eligible worldwide tax system prior to January 1, 2026 or a later date in accordance with applicable procedures.

An eligible domestic tax system is one that has: (a) at least a 20% statutory nominal corporate income tax (CIT) rate after taking into account preferential adjustments and sub-national corporate income taxes (where applicable); (b) a QDMTT or a corporate alternative minimum tax that is based on financial statement income, subject to appropriate adjustments consistent with the policy objectives of minimum taxation, at a nominal rate of at least 15%, and is applicable to a substantial portion of the aggregate income of in-scope MNE Groups' operations in the jurisdiction; and (c) no material risk that in-scope MNE Groups headquartered in the jurisdiction will be subject to an effective rate of tax (evaluated taking into account incentives consistent with the treatment of such incentives under the OECD GloBE Model Rules and agreed safe harbors) on the overall profits of their domestic operations below 15%.

An eligible worldwide tax system is one that: (a) has a comprehensive tax regime applicable to all resident corporations on foreign income and which is imposed on a broad base that: (i) includes the active and passive income of foreign branches and controlled foreign companies regardless of whether or not that income is distributed; and (ii) is only subject to limited income exclusions which are consistent with the

policy objectives of minimum taxation (for example, excluding categories of income which are generally high taxed); (b) incorporates substantial mechanisms which operate unilaterally to address BEPS risks; and (c) has no material risk that in-scope MNE Groups headquartered in the jurisdiction will be subject to an effective rate of tax (evaluated taking into account incentives consistent with the treatment of such incentives under the OECD GloBE Model Rules and agreed safe harbors) on the overall profits of their foreign operations below 15%.

Where an MNE Group has its UPE located in a jurisdiction with a Qualified SbS Regime and has made the election for this safe harbor to apply, the SbS Safe Harbor will apply to all of that MNE Group's controlled domestic and foreign operations.

The SbS Safe Harbor does not affect the application of QDMTTs and does not deem any Top-up Tax to be zero for the purposes of a QDMTT calculation. A QDMTT will continue to apply (including to the foreign operations of MNE Groups headquartered in a jurisdiction with a Qualified SbS Regime) and to be calculated without taking into account taxes imposed on permanent establishments or direct and indirect owners in respect of income of their controlled foreign companies (as required under paragraph 118.30 of the Commentary to the definition of QDMTT). Any such QDMTT will be creditable under the GMT and any Qualified SbS Regime. Accordingly, a jurisdiction cannot allow an MNE Group to apply the SbS Safe Harbor for the purposes of the QDMTT.

Where the IF has determined that a jurisdiction has a Qualified SbS Regime, that jurisdiction will be listed as such on the Central Record for purposes of the Global Minimum Tax — Qualified SbS Regime. To date, only the US is listed as Qualified SbS Regime in the Central Record (with a domestic law reference to the Internal Revenue Code of 1986 (Pub. L. 99-514, 100 Stat. 2085, enacted October 22, 1986) and a footnote clarifying that the IF determination of the US tax system took into account data provided by the US delegation with respect to tax years 2019 to 2022.⁶⁵³

b. UPE Safe Harbor

The UPE Safe Harbor applies for fiscal years commencing on or after January 1, 2026 and effectively replaces the Transitional UTPR Safe Harbor which expired at the end of 2025. At the election of the Filing Constituent Entity, the Top-up Tax for the UPE Jurisdiction for a fiscal year will be deemed to be zero for purposes of the UTPR where the Constituent Entities located in the UPE Jurisdiction are eligible for the UPE Safe Harbor. An MNE Group will be eligible for the UPE Safe Harbor for a fiscal year if the UPE of that MNE Group is located in a jurisdiction with a Qualified UPE Regime for that fiscal year.

⁶⁵² Unless the context requires otherwise all capitalized terms have the meaning as set forth in OECD (2022), *Tax Challenges Arising from the Digitalisation of the Economy — Commentary to the Global Anti-Base Erosion Model Rules (Pillar Two)*, First Edition: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, <https://doi.org/10.1787/1e0e9cd8-en>; OECD (2021), *Tax Challenges Arising from Digitalisation of the Economy — Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project*, OECD Publishing, Paris, <https://doi.org/10.1787/782bac33-en>.

⁶⁵³ It has been reported that, interestingly, the United States was included in the Central Record — Qualified SbS Regimes despite the fact that, under the U.S.'s net CFC tested income (formerly global intangible low-taxed income or GILTI) regime, net CFC tested income is only taxed at a rate of 12.6% (and no residual U.S. tax will be imposed on non-U.S. earnings if the rate of non-U.S. tax is at least 14%, taking into account the 90% foreign tax credit allowed by the U.S.). Given this falls below the 15% threshold, we can only surmise that the inclusion of the United States in the Central Record was based on a broader analysis of the overall U.S. tax system (see, <https://www.aoshearman.com/en/insights/the-side-by-side-package-and-the-global-minimum-tax-what-you-need-to-know#2>).

A jurisdiction has a Qualified UPE Regime if it has an eligible domestic tax system which was enacted and in effect as at January 1, 2026.

An eligible domestic tax system is one that has: (a) at least a 20% statutory nominal corporate income tax (CIT) rate after taking into account preferential adjustments and sub-national corporate income taxes (where applicable); (b) a QDMTT or a corporate alternative minimum tax based on financial statement income, subject to appropriate adjustments consistent with the policy objectives of minimum taxation, at a nominal rate of at least 15%, and is applicable to a substantial portion of the aggregate income of in-scope MNE Groups' operations in the jurisdiction; and (c) no material risk that in-scope MNE Groups headquartered in the jurisdiction will be subject to an effective rate of tax (evaluated taking into account incentives consistent with the treatment of such incentives under the GloBE Rules and agreed safe harbors) on the overall profits of their domestic operations below 15%.

Where the IF has determined that a jurisdiction has a Qualified UPE Regime, that jurisdiction will be listed as such on the Central Record.

The UPE Safe Harbor is applicable for fiscal years commencing on or after January 1, 2026.

The UPE Safe Harbor will not affect the application of the IIR or the UTPR with respect to any MNE Group with its UPE located in a jurisdiction which does not have a Qualified UPE Regime.

Similarly, the UPE Safe Harbor does not affect the application of the IIR or UTPR with respect to any of an MNE Group's Constituent Entities which are located outside of the UPE Jurisdiction.

The UPE Safe Harbor has no impact on the operation of QDMTTs.

5. EU Side-by-Side System Implementation Pursuant to Article 32 of the Pillar Two Directive

See the discussion at II.G.1.b., above.

VIII. FASTER Directive

A. General

Executive Summary

This Section provides an overview of the provisions of the FASTER Directive which aims to provide faster and safer relief from excess withholding taxes within the European Union.

1. Background and Purpose

Following a proposal launched by the Commission on June 19, 2023,⁶⁵⁴ the Council on December 10, 2024 adopted Council Directive (EU) 2025/50 on faster and safer relief of excess withholding taxes (commonly referred to as the “FASTER Directive”).⁶⁵⁵

Political agreement on the FASTER Directive was reached at Council level on May 14, 2024, subject to certain — in some instances admittedly rather substantive — amendments brought to the initial Commission proposal. Given these amendments, the EU Parliament had to be re-consulted on the proposal (non-binding advice), which it provided on November 14, 2024.⁶⁵⁶ The final compromise text was released on November 29, 2024 and, as indicated, formally adopted by the Council on December 10, 2024, including only legal-linguistic revisions and clarifications, with no substantial changes.

Broadly, the objective of the FASTER Directive is to introduce more efficient withholding tax procedures while, at the same time, providing Member States with the necessary tools to effectively fight tax fraud and abuse. This would support the good functioning of the Capital Market Union (CMU) and lead, according to the impact assessment report accompanying the Commission proposal, to cost savings for investors estimated at approximately 5.17 billion euros per year.

According to the Commission, the FASTER initiative should be seen as complementing the following:

- (i) The Parent-Subsidiary Directive (see IV., above);
- (ii) The Interest and Royalty Directive (see V., above);
- (iii) The Retail Investment Strategy;⁶⁵⁷ and
- (iv) The Shareholders Rights Directive (SRD).⁶⁵⁸

⁶⁵⁴ COM (2023) 324 final 2023/0187 (CNS), {SEC (2023) 243 final} — {SWD (2023) 215 final} — {SWD (2023) 216 final} — {SWD (2023) 217 final}.

⁶⁵⁵ <https://eur-lex.europa.eu/eli/dir/2025/50/oj/eng>.

⁶⁵⁶ https://www.europarl.europa.eu/doceo/document/TA-10-2024-0033_EN.html. The initial opinion of the EU Parliament was issued on February 28, 2024: https://www.europarl.europa.eu/doceo/document/TA-9-2024-0102_EN.html.

⁶⁵⁷ The Retail Investment Strategy, adopted on May 24, 2023, aims to empower consumers to take full advantage of EU capital markets; see Proposal for a Directive of the European Parliament and of the Council amending Directives (EU) 2009/65/EC, 2009/138/EC, 2011/61/EU, 2014/65/EU and (EU) 2016/97 as regards the Union retail investor protection rules (COM/2023/279 final).

⁶⁵⁸ Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement. The SRD is aimed at facilitating share-

The need to address the inefficiencies and the risk of fraud or abuse associated with withholding tax procedures has been on the international agenda for decades. Some of the most notable proposals in this area include:

- (i) A Recommendation to the Member States on simplifying withholding tax procedures⁶⁵⁹ put forward by the Commission in 2009;
- (ii) A Code of Conduct on withholding tax published by the Commission in 2017;⁶⁶⁰ and
- (iii) The Treaty Relief and Compliance Enhancement (TRACE) Implementation Package approved by the OECD in 2013.⁶⁶¹

However, none of these initiatives went on to produce any substantive outcomes, and the matter remained open. The FASTER Directive is considered to fill that legal void.

2. Structure of the Directive

The FASTER Directive is structured in four Chapters:

- (i) Chapter I (General Provisions) sets out the subject-matter of the Directive, its scope and the applicable definitions.
- (ii) Chapter II (Digital Tax Residence Certificate) provides for the creation of an EU-wide digital tax residence certificate.
- (iii) Chapter III (Withholding Tax Relief Procedure) deals with the withholding tax relief procedures. It includes the procedure for establishing National Registers for specific financial intermediaries (Certified Financial Intermediaries or CFIs), a standardized reporting obligation for such CFIs and the obligation for Member States to set up a relief at source system, a quick refund system or a combination of both to ensure swift and secure relief from withholding tax, based on tax treaties or domestic rules, for EU and non-EU investors, when certain transparency requirements are met.
- (iv) Chapter IV contains the Penalties and Final Provisions.

Chapters I and IV apply to (i.e., are binding on) all Member States. Chapter II applies to all Member States regarding all persons that are tax resident in their jurisdiction. The procedures laid down in Chapter III apply to all Member States that provide relief for excess withholding tax on dividends paid on publicly traded shares. Member States that provide relief for excess withholding tax on interest paid on publicly traded bonds may also apply.

holder identification and information flows between the shareholders and the securities issuer.

⁶⁵⁹ Commission Recommendation of October 19, 2009 on withholding tax relief procedures (OJ L 279, 24.10.2009, p. 8–11).

⁶⁶⁰ European Commission (2017), Code of conduct on withholding tax, Directorate-General Taxation and Customs Union, https://taxation-customs.ec.europa.eu/system/files/2017-12/code_of_conduct_on_withholding_tax.pdf.

⁶⁶¹ OECD (2013), TRACE implementation package for the adoption of the authorized intermediary system: A standardised system for effective withholding tax relief procedures for cross-border portfolio income.

Chapter III is not applicable to Member States that apply withholding tax on interest at varying rates and to Member States that need to engage in similar relief procedures or have in place a comprehensive relief at source system for dividend payments and have a market capitalization ratio (MCR) below 1.5%. The reason is that low market capitalization implies low volumes of dividend distributions and therefore a lower risk of tax abuse. Where a Member State does not fulfil or no longer fulfils at least one of the two conditions concerning the comprehensive relief-at-source system and the market capitalization ratio threshold, it should transpose into national legislation all provisions of the FASTER Directive.

B. Common Digital Tax Residence Certificate

1. Outline

The common digital tax residence certificate (eTRC) is to be introduced by all Member States and is aimed at providing a fast, easy and secure administrative process for confirming EU taxpayers' tax residency.

An eTRC is issued, through an automated process, by the relevant Member State (i.e., the Member State of residence) to persons deemed resident in its jurisdiction for tax purposes.

An eTRC must comply with the technical requirements set out in Annex I to the FASTER Directive and include the following information:

- (i) The first and last name and date and place of birth of the taxpayer, if the taxpayer is an individual, or the name and the European Unique Identifier number (EUID), if the taxpayer is an entity;
- (ii) The tax identification number or, in its absence, any functional equivalent used for tax purposes;
- (iii) The address of the taxpayer;
- (iv) The date of issuance;
- (v) The covered period;
- (vi) The identity of the tax authority issuing the certificate;
- (vii) One or more double tax treaties pursuant to which the taxpayer requests to be deemed resident for tax purposes in the Member State of issuance, where applicable; and
- (viii) Any additional information that is necessary for proving the taxpayer's residence for tax purposes insofar as the eTRC is not to be used for relief of excess withholding within the Union.

2. Administration

An eTRC is to be issued within 14 calendar days after the submission of a request. If more than 14 calendar days are required to verify the tax residency of a particular taxpayer, the issuing Member State must inform the person requesting the certificate of the additional time required and the reasons for the delay.

To meet the 14-calendar day issuance requirement, Member States must implement a fully automated system for issuing eTRCs that allows for requests via an online portal accessible to the taxpayer and parties authorized by the taxpayer (for ex-

ample, financial intermediaries requesting eTRCs on behalf of their clients).

The eTRCs will be secured using an electronic seal in conformity with Regulation (EU) No. 910/2014 of July 23, 2014 on electronic identification and trust services for electronic transactions in the internal market (the "eIDAS Regulation").

Once issued, an eTRC covers a period not exceeding the calendar or fiscal year for which it is issued and is valid for the covered period unless and until the issuing Member State has evidence that the person to which the eTRC refers is not resident in its jurisdiction. In other words, if the circumstances at the end of the year do not support the contents of the eTRC issued during the year, the eTRC can be deemed invalid by the issuing Member State and any other Member State concerned.

An eTRC issued in accordance with the foregoing is to be recognized by the other Member States as adequate proof of residence of a taxpayer in the issuing Member State.

The Commission is to adopt implementing acts specifying standard computerized forms, including the linguistic arrangements, and technical protocols, including security standards, for the issuance of an eTRC.

C. Withholding Tax Relief Procedure

The FASTER Directive introduces fast-track streamlined systems to be applied by Member States that:

- (i) Levy a withholding tax on dividends from publicly traded shares paid to registered owners tax resident outside those Member States; and
- (ii) Provide relief for excess withholding tax.

Member States that levy a withholding tax on interest on publicly traded bonds (whether or not they levy a withholding tax on dividends on publicly traded shares) may also opt to use these procedures in relation to relief for excess withholding tax on interest on publicly traded bonds, if applicable.

For the purposes of the FASTER Directive, "excess withholding tax" means the difference between the amount of withholding tax levied by a Member State on payments to non-resident owners of dividends or interest from securities by applying the general domestic rate and the lower amount of withholding tax applicable by that Member State on the same dividends or interest in accordance with a double tax treaty or specific national rules, as the case may be (Article 3.1(1)).

Member States have the option of providing:

- (i) A relief at source system;
- (ii) A quick refund system; or
- (iii) A combination of the two, provided at least one of the two systems is in place and available to all investors.

A "relief at source system" refers to a system where the appropriate withholding tax rate, in accordance with the applicable domestic rules and/or international agreements, such as the relevant tax treaty, is applied at the time a dividend or interest is paid (Article 3.1(30)).

A "quick refund system" refers to a system where a payment of dividends or interest is made taking into account the general domestic withholding tax rate, followed by a request for refund of the excess withholding tax within a specified timeframe (Article 3.1(29)). See further at F.3., below.

D. Certified Financial Intermediaries and National Registers

To benefit from the streamlined procedures, investors will have to contract with “certified financial intermediaries” (CFIs), i.e., financial intermediaries registered in national registers set up in accordance with the FASTER Directive in Member States that levy the relevant withholding taxes.

The following financial intermediaries are eligible to become CFIs:

- (i) Central securities depositories (within the meaning of the Central Securities Depositories Regulation (CSDR));
- (ii) Credit institutions (as defined in the Capital Requirements Regulation (CRR));
- (iii) Investment firms (as defined in the Markets in Financial Instruments Directive 2014 (MIFID II));
- (iv) A branch of any of the entities under (i), (ii) or (iii); and
- (v) Any financial intermediaries providing comparable services in third countries.⁶⁶²

Registration is compulsory for:

- (i) Large institutions (as defined in the CRR)⁶⁶³ that handle payments of dividends (and interest, where applicable) originating in their jurisdiction; and
- (ii) Central securities depositories that provide withholding tax agent services.

For other financial intermediaries, registration is voluntary.

The national registers to be established by the Member States must include the following information on a CFI:

- (i) The name of the CFI;
- (ii) The date of registration;
- (iii) The contact details and any existing website of the CFI;
- (iv) The effective user ID (EUID) or, where the CFI has no such number, the legal entity identifier (LEI) or any legal entity registration number issued by the CFI’s country of residence.

The national registers must be made publicly accessible on the European Certified Intermediary Portal (see Article 6), via a website of the Commission, and updated at least once a month.

A Member State that does not need to provide relief for excess withholding tax because:

- (i) The Member State provides for an exemption from withholding tax on dividend payments; or
- (ii) The relevant domestic tax rate is always lower than or equal to the rate that can be applied under the Member State’s tax treaties,

does not need to have a national register in place.

To be eligible for CFI status, a qualifying financial intermediary must be able to provide evidence that it meets all of the following requirements:

- (i) Residence for tax purposes in a Member State or third country jurisdiction that is included in neither Annex I of the EU list of non-cooperative jurisdictions for tax purposes (see XXII., below) nor table I of the Annex to Delegated Regulation (EU) 2016/1675;⁶⁶⁴
- (ii) If the requesting financial intermediary is a credit institution, an investment firm or a central securities depository, an authorization in the jurisdiction of residence for tax purposes to perform its activities under applicable legislation; and
- (iii) A declaration of compliance with applicable legislation.

While a Member State has an obligation to remove from its national register any CFI, where the CFI:

- (i) Requests removal; or
- (ii) No longer meets the requirements set out above,

a Member State is also permitted to remove from its national register any CFI where:

- (a) that CFI has been found not to have complied with its obligations under the FASTER Directive or the Anti-Money Laundering Directive 5 (Directive (EU) 2015/849); or
- (b) that CFI has been found to have committed one or more offences or infringements under the national rules of a Member State or another jurisdiction and such offences or infringements have led to a loss of withholding tax revenue; or
- (c) an inquiry is opened by a Member State or another jurisdiction in relation to the certified financial intermediary concerning potential tax fraud or tax abuse which could lead to a loss of withholding tax revenue.

A Member State must ensure that a financial intermediary removed from its national register is re-registered where such Member State determines that any non-compliance with the provisions of the FASTER Directive has been remedied.

E. Reporting Requirements

To prevent tax fraud and abuse in relation to withholding tax relief procedures, the FASTER Directive introduces common reporting procedures that should enable the source Member State to receive the information required to:

⁶⁶² Specifically, Article 3(4) of the FASTER Directive defines “financial intermediary” as a central securities depository as defined in Article 2(1) of Regulation (EU) 909/2014 of July 23, 2014, a credit institution as defined in point (1) of Article 4(1) of Regulation (EU) No. 575/2013 or an investment firm as defined in point (1) of Article 4(1) in Directive 2014/65/EU or a third country legal person that has been authorized to provide services comparable to those provided by a central securities depository, a credit institution or an investment firm under comparable legislation of a third country of residence, which is part of the securities payment chain between the entity issuing securities and the registered owner receiving payments on such securities.

⁶⁶³ A “large institution” means a large institution as defined in point (146) of Article 4(1) of Regulation (EU) No. 575/2013 (Article 3(10)).

⁶⁶⁴ Commission Delegated Regulation (EU) 2016/1675 of July 14, 2016 supplementing Directive (EU) 2015/849 of the European Parliament and of the Council by identifying high-risk third countries with strategic deficiencies.

- (i) Ensure that the correct withholding tax rate applies; and
- (ii) Assess whether anti-abuse rules have to be applied.

Reporting elements are set out in Annex II to the FASTER Proposal.

Heading E of Annex II sets out two reporting requirements aimed at combatting withholding tax abuse (see G., below).

Reporting is to take place via a standardized XML format scheme that will be set out in an implementing act to be adopted by the Commission. Reporting is to be made within the second month following the month of the payment date of the dividend or interest. Non-compliance with the reporting obligations will lead to penalties.

Under the FASTER Directive, each CFI must report only on the part of the transaction visible to it, i.e., the person from which it receives the dividend/interest concerned and the person to whom it pays the dividend/interest. Thus, the recipient of the full reporting — either the source tax administration or a withholding tax agent designated on the CFI's behalf — will have all the information required to reconstruct the financial chain of the transaction from the investor to the securities' issuer.

The information reported to the tax administration should enable it to ascertain the identity of the final investor and his or her potential entitlement to the reduced withholding tax rate. Hence, the risk of double refunds will be mitigated and the capacity for tax administrations to identify and combat other abusive and fraudulent practices will be enhanced (see G., below).

F. Procedural Aspects

1. Requests for Relief at Source or Quick Refund

A CFI maintaining the investment account of a registered owner receiving dividends or interest is required to request relief at source or a quick refund on behalf of the registered owner, if the following conditions are fulfilled:

- (i) The registered owner has authorized the CFI to request relief on its behalf; and
- (ii) The CFI has verified and established the registered owner's eligibility in accordance with the applicable due diligence procedures (see below).

The verification in (ii) may also include a risk assessment, taking into account credit and fraud risks.

A Member State may exclude a request from the relief at source or the quick refund system, where:

- (i) The dividend has been paid on a publicly traded share that the registered owner acquired in a transaction carried out within a period of five days before the ex-dividend date;
- (ii) The dividend payment on the underlying security for which relief is requested is linked to a financial arrangement that has not been settled, expired or otherwise terminated before the ex-dividend date;
- (iii) At least one of the financial intermediaries in the securities payment chain is not a CFI and a subsequent CFI in the chain has not provided to the competent authority the information that the financial intermediary would have to report if it were a CFI;

- (iv) A withholding tax exemption is claimed;
- (v) A reduced withholding tax rate not deriving from double tax treaties is claimed;
- (vi) The dividend payment exceeds a gross amount of at least 100,000 EUR, per registered owner and per payment date.

In addition, Member States are not to provide relief in the case of reported withholding tax abuse (i.e., the Cum/Ex and Cum/Cum schemes (see G., below)).

2. Due Diligence Procedures

To establish a registered owner's eligibility for a relief at source or a quick refund, a CFI is required to complete the following steps:

- (i) Obtain a declaration from the registered owner that the registered owner:
 - (a) Is the beneficial owner of the dividend or interest as defined under the national legislation of the source Member State; and
 - (b) Has not engaged in a financial arrangement linked to the underlying publicly traded share that has not been settled, expired or otherwise terminated at the ex-dividend date; and
- (ii) Verify:
 - (a) The eTRC of the registered owner and/or appropriate proof of tax residence in a third country;
 - (b) The registered owner's declaration and tax residence against information from the internal control mechanisms used by the CFI to comply with obligations under the Anti-Money Laundering Directive (Directive (EU) 2015/849) or comparable information required in third countries;
 - (c) The registered owner's entitlement to a specific reduced withholding tax rate in accordance with a tax treaty between the source Member State and the jurisdiction where the registered owner is resident for tax purposes or specific national legislation of the source Member State; and
 - (d) In the case of a dividend payment and based on the information available to the CFI, the possible existence of any financial arrangement that has not been settled, expired or otherwise terminated at the ex-dividend date.

3. Obligations of Certified Financial Intermediaries

Under the relief at source system, a CFI must provide the withholding agent with the following information:

- (i) The tax residence of the registered owner; and
- (ii) The applicable withholding tax rate on the payment in accordance with a tax treaty or specific national legislation.

Under the quick refund system, a CFI must provide the relevant Member State with the following information:

- (i) Identification of the dividend or interest payment as referred to in Annex II, heading B;

- (ii) The basis for the applicable withholding tax rate and the total amount of excess tax to be refunded;
- (iii) The tax residence of the registered owner; and
- (iv) The registered owner's declaration.

The information must be provided within the second month following the month of the payment of the dividend or interest.

Member States are to process refund requests made in accordance with the foregoing within 60 calendar days after the end of the period to request the quick refund. Member States are to apply interest on the amount of such a refund for each day of delay after the 60th day.

G. Anti-Abuse Measures

Member States are not to provide relief under a relief at source system or a quick refund system where:

- (i) The dividend concerned is paid on a publicly traded share that the registered owner acquired within a period of two days before the ex-dividend date; or
- (ii) The dividend payment on the underlying security for which relief is requested is linked to a financial arrangement that has not been settled, expired or otherwise terminated at the ex-dividend date (see Heading E of Annex II of the FASTER Directive).

The first exclusion is targeted at "Cum/Ex schemes," i.e., dividend stripping arrangements consisting of the acquisition of shares with ("cum") dividends due on or just before the dividend record date and delivery of these shares after the dividend record date without ("ex") dividends, thereby enabling the participating parties to claim multiple refunds of withholding tax that, in fact, has only been paid by one of the parties.

The second exclusion is aimed at tackling "Cum/Cum schemes," i.e., arrangements where taxpayers that have no entitlement to a lower withholding tax rate engage, immediately before a dividend distribution, in transactions (for example, spot market transactions, repurchase agreements, total swap return agreements or securities lending agreements) with entities able to benefit from a reduced withholding tax rate (for example, based on the relevant tax treaty or because of their special status), thereby splitting the withholding tax savings among themselves.

As the above schemes have been observed only in relation to dividend payments, compliance by CFIs with the related reporting elements under Heading E of Annex II is not required in relation to interest paid on bonds. The same holds true for very low amounts of dividends paid, which are considered low-risk cases that, in the Commission's opinion, cannot justify the relevant reporting burden on CFIs.

H. Penalties

Member States are to lay down rules on penalties applicable to infringements of national provisions adopted pursuant to the FASTER Directive and take all measures necessary to ensure that they are implemented. The penalties are to be effective, proportionate and dissuasive.

I. Transposition

The FASTER Directive is to be transposed into Member States' national law by December 31, 2028 and should come into effect two years after the implementing acts have been adopted, which is contemplated to be by January 1, 2030.

IX. Current EC Work Program/Blocked and Withdrawn EC Tax Proposals

A. 2026 Work Program — Omnibus on Taxation Initiative

As outlined in the 2026 EC Work Program of October 21, 2025, the Commission intends to propose a so-called Omnibus on taxation (directive) by the second quarter of 2026 with the aim to streamline, enhance and clarify the corporate tax directives, i.e., the Tax Merger Directive (see III., above), the Parent-Subsidiary Directive (see IV., above), the Interest and Royalty Directive (see V., above), the Anti-Tax Avoidance Directive (see VI., above), and the Double Taxation Dispute Resolution Mechanisms Directive (see XII.C., below).⁶⁶⁵

In this context, on February 16, 2026, a Call for Evidence for an Impact Assessment was launched by the Commission.

In the Call for Evidence document, the Commission raises the following concerns:

- First, the corporate tax directives include options for implementation at national level in several instances and this flexibility has created a fragmented EU landscape, as Member States took differing options in transposition;
- Second, the different material scope of the Parent-Subsidiary and the Interest and Royalty Directives have also contributed to this fragmented situation, affecting business structuring;
- Third, the scope of the Tax Merger Directive is no longer aligned with that of the Merger Directive under company law, creating undesired mismatches;
- Fourth, procedural requirements for accessing the benefits of the Parent-Subsidiary and Interest and Royalty Directives vary substantially between Member States, discouraging taxpayers from relying on the Directives;
- Finally, the rules laid down in the Double Taxation Dispute Resolution Mechanisms Directive have given rise to certain specific interpretative uncertainties that hinder its effective application.

The Call for Evidence document further emphasizes that the general objective of the Omnibus on taxation legislative initiative is to simplify the existing EU legal direct taxation framework and support the enhancement of competitiveness in the internal market, without undermining the important policy objectives of the Directives concerned. According to the Commission, this would involve:

- Reducing unnecessary reporting and the compliance burden;
- Eliminating outdated and overlapping tax rules;
- Simplifying tax legislation with the objective to improve competitiveness in the internal market;
- Clarifying concepts in tax legislation;

- Streamlining and improving the application of tax rules, procedures and reporting requirements.

The Commission further adds that the proposed policy options may involve legislative amendments in the following legal instruments:

- (1) The Controlled Foreign Company rule under the Anti-Tax Avoidance Directive — to eliminate overlaps with Pillar Two. In addition, there is a need to rectify the current fragmentation in the implementation of the rule by Member States, which is the result of the various available options to this effect.
- (2) The Interest Limitation Rules under the Anti-Tax Avoidance Directive — to address the procyclical effect of the rule, inflation effects, and consider the concerns of sectors that usually have high levels of legitimate leverage, as well as the needs of small and medium enterprises, including considerations of streamlining the rules.
- (3) The scope of the Parent-Subsidiary Directive, the Interest Royalty Directive and the Tax Merger Directive — to improve the efficiency of these Directives and, by extension, of the internal market.
- (4) The procedural rules to obtain the benefits of the Parent-Subsidiary Directive and the Interest Royalty Directive, with the aim of reducing the administrative burden and compliance costs for businesses and consequently enhancing the overall current functioning of the Directives.
- (5) Very limited and targeted amendments to the Double Taxation Dispute Resolution Mechanisms Directive, in particular the provisions regarding the admission phase, to remove ambiguities, ensure its consistent application across Member States and facilitate its use for taxpayers and tax administrations alike.

The legal basis for the Omnibus on taxation directive initiative is Article 115 of the TFEU, which enables the Commission to propose directives for the approximation of national laws of the Member States to ensure the proper functioning of the single market. The Council must adopt and issue these directives, acting unanimously in accordance with the special legislative procedure and after consulting the European Parliament and the Economic and Social Committee.

Noteworthy, while not mentioned in the 2026 EC Working Program, the Commission is also working on a recast and consolidation of DACs 1 to 9 into a single legislative instrument, also with Q2 2026 as indicative timetable. The driver behind this initiative is the concern that the current fragmentation of the legal framework, resulting from multiple successive amendments, has materially reduced legal clarity, increased compliance costs, and contributed to divergent national interpretations, most notably in relation to DAC 6, DAC 7, and the interaction between DAC 4 and DAC 9. See XXI.K., below.

B. Blocked and Withdrawn EC Tax Proposals

1. Financial Transaction Tax (FTT)

On September 28, 2011, the Commission tabled a proposal for a Council Directive on a common system of financial transaction tax (FTT) and the amendment of Directive 2008/7/EC

⁶⁶⁵ See also, the EU Commission's Directorate-General for Taxation and Customs (TAXUD) Management Plan for 2026: https://commission.europa.eu/document/download/e28d5bff-1425-474c-a06b-4c557061f8c6_en?file-name=taxud_mp_2026_en.pdf.

(concerning indirect taxes on the raising of capital).⁶⁶⁶ After a rather shaky process,⁶⁶⁷ on February 14, 2013, the Commission scheduled for consideration its proposal for a Council Directive implementing enhanced cooperation in the area of financial transaction tax based on Article 113 of the TFEU (the “2013 FTT Proposal”).⁶⁶⁸

Under the 2013 FTT Proposal, qualifying financial institutions (broadly defined to include investment firms, organized markets, credit institutions, insurance and reinsurance undertakings, collective investment undertakings and their managers, pension funds and their managers, holding companies, finance leasing companies and special purpose entities) would be imposed an FTT when acting as party to financial transactions, either for their own account or for the account of other persons, or acting in the name of a party to such transactions.

Transactions with the European Central Bank, the European Financial Stability Facility, the European Stability Mechanism, the European Union where it exercises the function of managing its assets or balance of payments loans or similar activities, and the central banks of Member States (but not the central banks of non-participating Member States) were excluded from the scope of the 2013 FTT Proposal.

The FTT was designed to tax gross transactions before any netting off. Covered transactions included transactions relating to all types of financial instruments as they are often close substitutes for each other. As such, the scope of the FTT extended to instruments that are negotiable on the capital market, money-market instruments (with the exception of payment instruments), units or shares in collective investment undertakings, including Undertakings for Collective Investment in Transferable Securities (UCITS) and Alternative Investment Funds (AIFs),⁶⁶⁹ and derivatives contracts. In addition, exchanges of financial instruments, as well as repurchase and reverse repurchase agreements, and securities lending and borrowing agreements were explicitly included within the scope of the FTT.

⁶⁶⁶ COM (2011) 594 final.

⁶⁶⁷ The European Parliament and the Economic and Social Committee delivered their favorable opinions on the Proposal on May 23, 2012 and March 29, 2012, respectively. At the Council meetings of June 22 and July 10, 2012, it was ascertained that essential differences in opinion persisted as regards the need to establish a common FTT system at the EU level and that the principle of a harmonized tax on financial transactions was unlikely to receive unanimous support within the Council in the foreseeable future. Based on a request from 11 Member States (Austria, Belgium, Estonia, France, Germany, Greece, Italy, Portugal, Slovakia, Slovenia and Spain), the Commission submitted a proposal to the Council to authorize enhanced cooperation (based on TEU, Art. 20 and the detailed rules set out in TFEU, Part VI, Title III (Arts. 326 *et seq.*)) in the area of the FTT. After receiving the consent of the European Parliament on December 12, 2012, the Council authorized the enhanced cooperation procedure on January 23, 2013. The United Kingdom brought action against the Council’s decision before the CJEU, which dismissed it on April 30, 2014 (Case C-209/13, *United Kingdom v. Council*).

⁶⁶⁸ COM (2013) 71 final.

⁶⁶⁹ Reference is made to the definition of financial instruments in Annex I to Directive 2004/39/EC of the European Parliament and of the Council of April 21, 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC (OJ L 145, April 30, 2004, p. 1). This definition covers units in collective investment undertakings. Consequently, shares and units of undertakings for collective investment in transferable securities (UCITS) as defined in Directive 2009/65/EC, Art. 1(2) (OJ L 302, November 17, 2009, p. 32) and alternative investment funds (AIFs) as defined in Directive 2011/61/EU, Art. 4(1)(a) (OJ L 174, July 1, 2011, p. 1) are financial instruments.

To prevent tax avoidance, each material modification of a taxable financial transaction would be considered a new taxable financial transaction of the same type as the original transaction. Spot currency transactions were not taxable financial transactions, but currency derivative contracts were. Derivative contracts relating to commodities were also covered, but physical commodity transactions were not. Structured products, meaning tradable securities or other financial instruments offered by way of a securitization, could also form the object of taxable financial transactions. The 2013 FTT Proposal contained an exclusion for primary market issuances. Also, currency transactions on spot markets were outside the scope of the FTT, thus preserving the free movement of capital. However, derivatives contracts based on currency transactions were covered by the FTT since they are not, as such, currency transactions. It is unclear whether certain products, such as life insurance, were within or outside the scope of FTT, as they are not expressly excluded in the 2013 FTT Proposal.

The imposition of FTT faced fierce opposition on the grounds that it would: harm businesses and investors; impede the efficiency of markets; impair the depth and liquidity of markets; raise costs for issuers, investors and retirees; and distort capital flows by discriminating against certain asset classes. Another recurring concern was that the tax was designed to be extraterritorial, and, as such, would collect revenue from financial markets and investors around the world with which the (minority of) EU countries that support the tax have little or no connection. The United States — which had a domestic FTT that was eliminated under the Kennedy and Johnson administrations in the 1960s — proved among the main opponents of the introduction of an FTT. EU Member States such as Luxembourg, Sweden and the United Kingdom, while not participating in the FTT, were nevertheless concerned about the effects it would likely have on their domestic financial services industries. In addition, many industry bodies voiced concerns about the potential unintended consequences of the FTT.⁶⁷⁰

Against this backdrop, little (if any) progress had been made on the FTT for years. Eventually, the June 20, 2023 Commission Staff Working Document Accompanying the document Amended Proposal for a Council Decision amending Decision (EU, Euratom) 2020/2053 on the system of own resources of the European Union⁶⁷¹ states that “the prospects of reaching an agreement in the future are limited” and that, hence, “[t]here is little expectation that any proposal would be agreed in the short term”.

Annex IV of the 2026 EC Work Program, in its point 1, tables the FTT Proposal as withdrawn.

⁶⁷⁰ For example, the U.S.-based Investment Company Institute (ICI Global) stated that the FTT would adversely affect repurchase agreements between US money market funds and financial institutions in the FTT jurisdictions, as it would produce negative net yields on repo transactions in the (then) low interest-rate environment. Moreover, since repos have short maturity terms (normally seven days or less), they may be rolled over 52 or more times per year, with the tax being incurred on each occasion. According to ICI Global, the FTT could, therefore, eliminate repos as a potential source of funding for financial institutions in FTT jurisdictions, such as French and German banks.

⁶⁷¹ SWD(2023) 331 final; {COM(2023) 331 final}.

2. Common Corporate Tax Base and Common Consolidated Corporate Tax Base

On October 25, 2016, the Commission tabled, at the same time and as part of a single initiative, two proposals: one for a common corporate tax base (CCTB) and another for the Common Consolidated Corporate Tax Base (CCCTB) (respectively, the “CCTB Proposal” and the “CCCTB Proposal” and, jointly, the “C(C)CTB Proposals”).⁶⁷²

The CCTB Proposal was intended to establish a system for a common base for the taxation of certain companies (i.e., essentially companies belonging to a consolidated group for financial accounting purposes with a total consolidated group revenue that exceeding 750 million euros) and to lay down rules for the calculation of that base. A company that applied these rules would cease to be subject to the national corporate tax law with respect to all matters regulated by the CCTB.

In a second step, i.e., once the common base had been secured, consolidation would be introduced. To this end, the CCCTB Proposal provided for a system of standardized rules for computing (based on the CCTB rules) the tax base of a (qualifying) corporate group with subsidiaries and/or permanent establishments (PEs) in EU Member States, allowing it to consolidate its profits and losses. The consolidated result would subsequently be allocated by means of an apportionment formula to the group members in the Member States in which the group has a taxable presence. The Member States would then apply their own national tax rates to the allocated amounts to calculate the tax due in each Member State. In essence, the CCCTB system meant that a group of companies would only have to comply with one EU system for computing its taxable profits and would only be required to file a single tax return with a single tax authority.

Since no consensus could be reached among the Member States, in its May 18, 2021 Communication to the European Parliament and the Council entitled “Business Taxation for the 21st Century,”⁶⁷³ the Commission announced the withdrawal of the C(C)CTB Proposals and their replacement by a proposal for a new framework for income taxation for businesses in Europe, to be known as “Business in Europe: Framework for Income Taxation” (the BEFIT Proposal) (see X., below).

Variances between the C(C)CTB Proposal and the currently pending BEFIT Proposal are generally set out in the summary chart below.

	C(C)CTB Proposal 2016	BEFIT Proposal 2023
<i>Harmonized Income Definition</i>	Taxable profits as defined under the common tax base rules.	Financial profits as defined by accounting standards and adjusted to align closer to taxable profits.
<i>National Taxable Income Definition</i>	Common tax base rules with minor national adjustments.	National tax rules.
<i>Income Allocation</i>	Formulary apportionment to jurisdictions based on three equally weighted factors (i.e. labor, payroll and number of employees; tangible assets; and sales by destination)	Share of BEFIT base originating in a jurisdiction in function of the previous three years’ profitability in the jurisdiction. Formulary apportionment possibly at a later stage.
<i>Loss Carry-overs</i>	Carryforward without time limitation to subsequent tax years but may not create a loss for that year deferred tax asset). No carry-backs.	Yes, unclear on time limitations.
<i>Loss Offsets Between Subsidiaries</i>	EU-wide subject to time limits and other restrictions.	EU-wide.
<i>Depreciation</i>	CCCTB common depreciation schedules (straight line depreciation). National option for 25% declining balance depreciation for short-lived assets. Super-deductions for R&D expenses.	BEFIT common depreciation schedules; straight line depreciation for assets over 5,000 euros.
<i>Inventory</i>	LIFO	FIFO or Average Cost
<i>Allowance for Corporate Equity</i>	Yes.	No.
<i>Threshold for Application</i>	750 million euros in global revenues.	750 million euros in global revenues, additional criteria for enterprises with an EU ownership share below the 75% threshold.

⁶⁷² COM (2016) 685 final, 2016/0337 (CNS), see also Staff Working Documents {SWD (2016) 341} {SWD (2016) 342} and COM (2016) 683 final, 2016/0336 (CNS), see also Staff Working Documents {SWD (2016) 341 final} and {SWD (2016) 342 final}. Simultaneously, the initial Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (COM (2011) 121 final), launched on March 16, 2011, which since its publication had been met with opposition from various Member States, either by way of the formal objection procedure (popularly known as the “yellow card” procedure) or informally (e.g., via government statements) was repealed. In an attempt to facilitate the legislative process, the initial Proposal was broken down in two building blocks, i.e., one dealing with the CCTB and the other with the CCCTB.

⁶⁷³ https://taxation-customs.ec.europa.eu/system/files/2021-05/communication_on_business_taxation_for_the_21st_century.pdf.

3. Taxation of Digital Presence and Digital Services

On March 21, 2018, the Commission tabled: (i) a Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence (the “SDP Proposal”),⁶⁷⁴ as an end-objective; and (ii) a Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services (the “DST Proposal”),⁶⁷⁵ as a transitory solution pending realization of the comprehensive solution aimed at in the SDP Proposal. In parallel, also on March 21, 2018, the Commission issued a Recommendation relating to the corporate taxation of a significant digital presence urging Member States to replicate the provisions included in the SDP Proposal (once adopted) in their tax treaties with non-EU jurisdictions in order: (i) to extend the concept of a PE to include a significant digital presence through which the business of an enterprise is wholly or partly carried on in another jurisdiction; and (ii) to include rules for attributing profits to or with respect to a significant digital presence (the “SDP Recommendation”).⁶⁷⁶

The SDP Proposal was aimed at laying down rules extending the concept of a PE to include a significant digital presence through which a business is wholly or partly carried on as well as certain principles for attributing profits to or with respect to a significant digital presence for corporate tax purposes. Specifically, under the SDP Proposal, a significant digital presence was deemed to exist if the business carried on through that presence consisted wholly or partly of the supply of digital services through a digital interface, provided certain revenue, user and business contract thresholds were achieved. “Digital services” were defined to mean services delivered over the internet or an electronic network, the nature of which renders their supply essentially automated and involving of minimal human intervention, and impossible to ensure in the absence of information technology. “Profits attributable to or in respect of the significant digital presence” were considered to be those that the digital presence would have earned if it had been a separate and independent enterprise performing the same or similar activities under the same or similar conditions, in particular in its dealings with other parts of the enterprise, taking into account the functions performed, assets used and risks assumed, through a digital interface.

Pending the realization of the comprehensive solution aimed at in the SDP Proposal, the DST Proposal established, as a temporary and interim solution, the common system of a digital services tax (DST) on the revenues resulting from the provision of certain digital services. The DST was structured as a turnover tax targeting the transmission for consideration of data obtained from users’ activities on digital interfaces. More specifically, the DST Proposal defined “taxable revenues” (of a given tax period, meaning a calendar year) as a function of user value creation, i.e., gross revenues, net of VAT and other similar taxes, generated by each of the following services:

(i) The placing on a digital interface of advertising targeted at users of that interface, whether or not the digital interface is owned by the entity responsible for placing the advertising on it;

(ii) The making available to users of a multi-sided digital interface that allows users to find other users and to interact with them, and that may also facilitate the provision of underlying supplies of goods or services directly between users (intermediation services), subject to certain exclusions;

(iii) The transmission of data collected about users and generated from users’ activities on digital interfaces, excluding the transmission of data by a trading venue, systematic internalizer or regulated crowdfunding service provider.

For purposes of the DST, a taxable person meant an entity, whether established in a Member State or in a non-EU jurisdiction, that fulfills both the following conditions: (i) the total amount of worldwide revenues reported by the entity for the relevant financial year exceeds 750 million euros; and (ii) the total amount of taxable revenues obtained by the entity within the European Union during the relevant financial year exceeds 50 million euros.

The DST was to be due in the Member State or Member States where the users are located. In the case of users involved in a taxable service who are located in different Member States or non-EU jurisdictions, the taxable revenues obtained by an entity from the provision of that service were to be distributed to each Member State proportionally by applying the allocation keys set out in the DST Proposal.

The DST rate was established at 3%.

The Commission’s hopes were for the proposals to be adopted before May 2019 (i.e., before the European elections). However, it quickly became apparent that Member States were divided on the need for a new tax.

Some considered the SDP Proposal to be premature given the developments at the OECD level on BEPS Action 1, Addressing the Tax Challenges of the Digital Economy, which was thought should offer the permanent solution. In addition, it was felt that thresholds and conditions for establishing a taxable nexus based on a significant (digital) economic rather than physical presence, such as significant digital presence, would potentially risk ringfencing certain cyber-physical transactions, an approach that was radically rejected in the 2015 OECD Final Report on BEPS Action 1. Also, some contended that it was not clear how businesses that rely on both a digital and a physical presence would be treated.

On the other hand, the smaller Member States were concerned that the interim solution set forth in the DST Proposal would either cause damage to their banking systems (Ireland, Luxembourg, the Netherlands and Cyprus) or not be of any benefit to them because the threshold for the companies concerned was too high (the Czech Republic and Slovakia). A further concern related to the fact that the gross taxation of digital (including sharing economy) transactions involving remote providers (only) might not comply with international trade law. Finally, since half of the companies expected to be targeted by

⁶⁷⁴ COM (2018) 147 final 2018/0072 (CNS); [see also](#) Staff Working Documents {SWD (2018) 81 final} and {SWD (2018) 82 final}.

⁶⁷⁵ COM (2018) 148 final 2018/0073 (CNS); [see also](#) Staff Working Documents {SWD (2018) 81} – {SWD (2018) 82}.

⁶⁷⁶ C(2018) 1650 final.

the new rules would be US-based, fierce opposition came from the United States.⁶⁷⁷

Against this backdrop, EU finance ministers on March 12, 2019 formally abandoned the proposal to introduce a DST.

Nonetheless, Annex III of the 2026 EC Working Program, in its points 55 and 56, continues to table both the DST and SDP Proposals as “pending”, adding to the confusion on the precise status of these legislative initiatives.

4. DEBRA Proposal

On May 11, 2022, the EU Commission launched a Proposal for a Council Directive on laying down rules on a debt-equity bias reduction allowance and on limiting the deductibility of interest for corporate income tax purposes (the “DEBRA Proposal”).⁶⁷⁸

With a view to addressing the tax-induced debt-equity bias across the single market in a coordinated way, the DEBRA Proposal was aimed at laying down rules that would:

- (i) Subject to certain conditions, provide for the deductibility for tax purposes of notional interest on increases in equity; and
- (ii) Limit the tax deductibility of excessive borrowing costs to apply in parallel with the ATAD 1 excess borrowing costs rule (see VI.B.2., above).

The proposed allowance on equity was to be computed by multiplying the allowance base by the relevant notional interest rate (NIR):

(Allowance on equity = Allowance Base × NIR),

where:

- (i) The “allowance base” would be calculated as the difference between the level of net equity at the end of the tax period concerned and the level of net equity at the end of the previous tax period;
- (ii) “Equity” was defined by reference to the Accounting Directive (Directive 2013/34/EU), and “net equity” was defined as the difference between the equity of a taxpayer and the sum of the tax value of its participation in the capital of associated enterprises and its own shares;
- (iii) The proposed NIR was based on two components:

(a) The risk-free interest rate, i.e., risk-free interest rate with a term to maturity of 10 years for the relevant currency; and

(b) The risk premium set at 1% (1.5% for taxpayers qualifying as SMEs).

The allowance would be granted for 10 years to approximate the term to maturity of most debt and was to be limited to a maximum of 30% of a taxpayer’s EBITDA for each tax year, subject to possibilities of carry forward.

A number of anti-abuse measures were set out in the DEBRA Proposal.

The proposed limitation on the tax deductibility of debt-related interest payments was aimed at introducing a proportional restriction to 85% of excess borrowing costs (i.e., interest paid minus interest received).

Since interest limitation rules already apply in the European Union under Article 4 of the ATAD 1 (see VI.B.2., above), taxpayers would be required to apply the DEBRA Proposal rule first and only subsequently calculate the limitation applicable under ATAD 1. If the application of the ATAD 1 provisions results in a lower deductible amount, the taxpayer would be entitled to carry forward or back the difference in accordance with Article 4.

The DEBRA Proposal was felt to present a potential overlap with the existing ATAD 1 provisions and domestic thin capitalization rules, risked to have an impact on the Pillar Two Directive (see VII., above) (i.e., to the extent the allowance on equity could potentially reduce the effective tax rate of qualifying taxpayers), and potentially raised issues of compatibility with primary EU law (in particular, the rules on State aid). As a result, the Proposal was withdrawn (see Annex IV of the 2026 EC Working Program, point 5).

5. Proposed ATAD 3 — Prevention of Misuse of Shell Entities

On December 22, 2021, the EU Commission presented a Proposal for a Council Directive laying down rules to prevent the misuse of shell entities for tax purposes and amending Directive 2011/16/EU (the “Anti-Shell Proposal” or “Unshell Proposal,” also commonly referred to as the “ATAD 3 Proposal”).⁶⁷⁹

The Anti-Shell Proposal built on the existing framework and systems for the automatic exchange of information using a Central Directory for advance cross-border rulings (“DAC 3”) and reportable cross-border tax arrangements (“DAC 6”) (see, respectively, XXI.D. and XXI.G., below) and was targeted at the perceived misuse of shell entities for improper tax purposes.

In short, the Anti-Shell Proposal was intended to ensure that shell companies in the European Union⁶⁸⁰ that have no or

⁶⁷⁷ Illustrative of this was the statement issued by US Treasury Secretary Steven T. Mnuchin on March 16, 2018 to the effect that “[t]he United States firmly opposes proposals by any country to single out digital companies. Some of these companies are among the greatest contributors to US job creation and economic growth. Imposing new and redundant tax burdens would inhibit growth and ultimately harm workers and consumers. I fully support international cooperation to address broader tax challenges arising from the modern economy and to put the international tax system on a more sustainable footing.” On June 2, 2020, the Office of the US Trade Representative (USTR) initiated investigations under Trade Act of 1974, Sec. 301 into digital services taxes adopted or under consideration in Austria, Brazil, the Czech Republic, the European Union, India, Indonesia, Italy, Spain, Turkey and the United Kingdom.

⁶⁷⁸ COM (2022) 216 final; {SEC (2022) 204 final} — {SWD (2022) 144 final} — {SWD (2022) 145 final} — {SWD (2022) 146 final}; 2022/0154 (CNS). On the same date, the Commission published a Q&A on the DEBRA Proposal on its website: https://ec.europa.eu/commission/presscorner/detail/en/QANDA_22_2885.

⁶⁷⁹ COM (2021) 565 final; {SEC (2021) 565 final} — {SWD (2021) 577 final} — {SWD (2021) 578 final} — {SWD (2021) 579 final}; 2021/0434 (CNS).

⁶⁸⁰ While the Anti-Shell Proposal addressed the issue inside the European Union, the Commission announced that, at some point in 2022, it would present a new initiative to respond to the challenges raised by non-EU shell entities. Pending that initiative, the EU Member States’ domestic (anti-abuse) rules (if any) would continue to apply to identify shell entities not captured by the Anti-Shell Proposal, once adopted as a Directive.

minimal economic activity are unable to benefit from any tax advantages, thereby discouraging their use. More specifically, the Anti-Shell Proposal targeted a particular scheme used for tax avoidance or tax evasion purposes, i.e., the setting up of undertakings within the European Union that are presumed to be engaged in an economic activity but, in reality, do not conduct any economic activity. Instead, the reason for which they are in place is to enable certain tax advantages to flow to their beneficial owners or to the group to which they belong, as a whole.

The Anti-Shell Proposal relied on a seven-step mechanism, the result of which was to determine whether a given entity is:

- (i) Out of scope;
- (ii) In-scope and subject only to requirements regarding the exchange of information between EU Member States; or
- (iii) In-scope and lacking substance, and thus subject to exchange of information requirements as well as adverse tax consequences.

An in-scope entity was defined as an entity that met the three cumulative requirements (referred to as the “gateways”). If, based on a self-assessment, an entity passed through all three gateways, it would be considered to be “at risk” of qualifying as a shell entity and would thus have to comply with the reporting obligations discussed below.

The Anti-Shell Proposal defined the gateways as follows:

- (i) More than 75% of the entity’s revenue in the previous two tax years consisted of “relevant income,” i.e.:

- Interest or any other income generated from financial assets, including crypto-assets;
- Royalties or any other income generated from intellectual or intangible property or tradable permits;
- Dividends and income from the disposal of shares;
- Income from finance leasing;
- Income from immovable property;
- Income from movable property, other than cash, shares or securities, held for private purposes and with a book value of more than one million euros;
- Income from insurance, banking and other financial activities; and
- Income from services that the undertaking has outsourced to other associated enterprises;

- (ii) The undertaking was engaged in cross-border activity and:

- More than 60% of the book value of the undertaking’s assets that generated income from immovable property or income from movable property, other than cash, shares or securities, held for private purposes and with a book value of more than one million euros, was located outside the EU Member State of the undertaking in the preceding two tax years;
- At least 60% of the undertaking’s relevant income was earned or paid out via cross-border transactions; and

- (iii) In the preceding two tax years, the undertaking outsourced the administration of its day-to-day operations and decision-making on significant functions.⁶⁸¹

Undertakings falling into any of the following categories were considered to be out of scope:

- (i) Companies with a transferable security admitted to trading or listed on a regulated market or multilateral trading facility (as defined in Directive 2014/65/EU);
- (ii) Regulated financial undertakings;
- (iii) Undertakings whose main activity was the holding of shares in local operational businesses in circumstances where the beneficial owners are also tax resident in the same Member State;
- (iv) Undertakings with holding activities that were resident for tax purposes in the same Member State as the undertaking’s shareholder(s) or the ultimate parent entity (as defined in Section I, point 7, of Annex III to Directive 2011/16/EU); and
- (v) Undertakings with at least five full-time equivalent employees or members of staff engaged exclusively in the activities generating the relevant income.

Under the Anti-Shell Proposal, an in-scope entity would be required to declare in its annual tax return, for each tax year, whether a number of (cumulative) indicators of minimum substance were present.

An in-scope entity not meeting the (cumulative) substance indicators test would be presumed (rebuttable presumption) not to have the required minimum substance and would, in principle, qualify as a misused “shell entity.”

An in-scope undertaking that did not meet the cumulative substance indicators test and was unable to avail itself of the rebuttal rule (see VI.B.4., above) would be presumed to be an abusive shell entity, and therefore face tax consequences, both in its own Member State and in other Member States.

The tax consequences of an undertaking not having minimum substance for tax purposes in Member States other than its own were to include:

- (i) Denial of exemptions in the Member State of source under any agreements or conventions (including the EU fundamental freedoms) providing for the elimination of double taxation of income and, where applicable, capital that are in force with the undertaking’s Member State of residence and denial of any benefits under the Parent-Subsidiary Directive or the Interest and Royalty Directive;
- (ii) Pick-up of income at the level of the shareholders (a CFC-like rule);
- (iii) Disregarding of real estate holding companies: real estate held by a shell entity in another Member State would

⁶⁸¹ The Proposal made it clear that this requirement focus on entities that did not have adequate own resources and engaged third party providers of administration, management, correspondence, and legal compliance services, or entered into relevant agreements with associated enterprises for the supply of such services. However, the mere outsourcing of certain ancillary services, such as bookkeeping services, while the core activities were kept within the entity, was not sufficient to meet this requirement, and therefore an entity acting in this manner would not have been within the scope of the rules.

be taxed in accordance with the domestic law of the Member State in which the real estate is located, as if the real estate were owned by the shareholder(s) of the shell entity directly.

The tax consequences of an undertaking not having minimum substance for tax purposes in its own EU Member State would oblige it to either:

- (i) Denial of a tax residence certificate; or
- (ii) Issuance of a tax residence certificate stating that the shell entity was not entitled to the benefits of any Directive or tax treaty.

The Anti-Shell Proposal attracted severe criticism culminating in the conclusion that the analysis of the Proposal should not be continued in the Council as there are potential overlaps between the hallmarks in that Proposal and those in DAC 6 (“Intermediaries/Reportable Cross-Border Arrangements.” See the discussion at XXI.G., below). Such overlaps could entail the risk that under a possible future Anti-Shell Directive, similar information would have to be reported twice, probably through separate IT systems. Moreover, the objectives of DAC 6, such as strengthening tax transparency and fighting aggressive tax planning, coincide with the goals of the Anti-Shell Proposal, implying that the aims of the Proposal could be achieved with clarifications to or amendments of the hallmarks in DAC 6. Annex IV of the 2026 EC Work Program, in its point 4, tables the Anti-Shell Proposal as withdrawn.

6. *Transfer Pricing Proposal*

On September 12, 2023, the Commission launched a Proposal for a Council Directive on Transfer Pricing of September 12, 2023, aimed at integrating the key transfer pricing principles into EU law with a view to putting forward certain common approaches for the Member States (the “Transfer Pricing Proposal”).⁶⁸²

Specifically, the Proposal was intended to incorporate the OECD arm’s length principle into EU law, harmonize the key transfer pricing rules, clarify the role and status of the OECD Transfer Pricing Guidelines and make it possible to establish, within the European Union, common binding rules on specific transfer pricing subjects within the framework of the OECD Transfer Pricing Guidelines.

The October 2024 discussions at the Council level revealed that the Transfer Pricing Proposal was facing fierce opposition from Member States, which reportedly had concerns over creating a transfer pricing double standard and losing flexibility in negotiating and applying the OECD Transfer Pricing Guidelines. Against this backdrop, as stated in point 8 of the Annex IV of the 2026 EC Work Program, the Transfer Pricing Proposal was withdrawn.

⁶⁸² {SWD (2023) 308–309 final}; COM (2023) 529 final; 2023/0322 (CNS).

X. BEFIT Proposal

A. Background

Executive Summary

This Section discusses the “Business in Europe: Framework for Income Taxation” or BEFIT Proposal. The BEFIT Proposal would introduce a common framework for corporate income taxation in the European Union by replacing the (current) 27 different approaches to determining the taxable base of corporate groups with annual combined revenues exceeding 750 million euros.

The BEFIT Proposal should to a large degree be seen as a successor to the Commission’s earlier efforts to introduce a common corporate tax base (CCTB) and a common consolidated corporate tax base (CCCTB) (efforts that were withdrawn in May 2021, see IX.B.2., above). The BEFIT Proposal comprises elements of both mandatory and optional application, combined with limited tax adjustments for tax base computation purposes, a gradual transitional tax base allocation rule and a limited one-stop-shop for administrative purposes.

Whilst the BEFIT proposal may face challenges in passing all the necessary hurdles in adoption as a Directive, as of the 2025 Work Programme of the EU Commission, the proposal is still listed as “pending”, suggesting it is still under active consideration.

On March 16, 2011, the European Commission issued a Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (the “2011 CCCTB Proposal”).⁶⁸³ The general objective of this proposal was to enhance the simplicity and efficiency of the corporate income tax systems in the European Union, thus contributing to the better functioning of the internal market.

In summary, the proposal’s objectives were to:

- (i) Reduce tax-related compliance costs for companies;
- (ii) Eliminate double taxation; and
- (iii) Eliminate the over-taxation of cross-border economic activity, including by enabling cross-border loss relief.

Under the 2011 CCCTB Proposal, the CCCTB was a system of standardized rules for computing the tax base of a (qualifying) corporate group with subsidiaries and/or PEs in EU Member States, allowing it to consolidate its profits and losses. The consolidated result was subsequently to be allocated by means of an apportionment formula to the group members in the Member States in which the group had a taxable presence. Member States would then apply their own national tax rates to the relevant amounts to calculate the tax due in each jurisdiction.

The building blocks of the CCCTB were:

- (i) Depreciation and assets;
- (ii) Provisions and reserves;
- (iii) Taxable income;
- (iv) Foreign income and relations outside the European Union;
- (v) Consolidation; and
- (vi) Formulary apportionment.

In essence, the CCCTB was intended to ensure that a group of companies operating cross-border would only be required to:

- (i) Comply with one Member State’s set of rules to compute its taxable profits; and
- (ii) File a single tax return with a single tax authority.

However, the 2011 CCCTB Proposal met with fierce opposition from a number of Member States, either by way of the formal objection procedure, commonly known as the “yellow card” procedure, or informally, for example, via government statements.

On June 17, 2015, the Commission announced, as part of its Action Plan for Fair and Efficient Corporate Taxation in the European Union,⁶⁸⁴ that it would come forward with a proposal to revive the CCCTB within 18 months. The proposal would be for a mandatory CCCTB, at least for multinational companies, that would be introduced via a step-by-step approach. Initially, consolidation would be postponed, allowing Member States to progress more quickly on other aspects of the CCCTB (particularly, the common base and the international elements designed to prevent base erosion and profit shifting (an element of cross-border loss relief would also be included)). Once the common base was secured, consolidation would be introduced as the second step.

Accordingly, on October 25, 2016, the Commission relaunched the CCCTB project by submitting, at the same time and as part of a single initiative, two proposals: one for a common corporate tax base (CCTB) and another for the CCCTB (with a simultaneous repeal of the 2011 CCCTB Proposal).

Following their relaunch, concerns continued to be raised with respect to the CCTB and CCCTB Proposals. These concerns related to:

- (i) The erosion of national tax sovereignty implied by the Proposals and the effect this could have on the ability of Member States to react flexibly to fiscal and economic issues in the future;
- (ii) The potential impact of the Proposals on Member States’ national budgets;
- (iii) The, perhaps unfortunate, timing of the Proposals as Member States’ national tax regimes found themselves already under pressure from the many OECD BEPS-related changes;

⁶⁸³ COM (2011) 121 final.

⁶⁸⁴ Communication from the Commission to the European Parliament and the Council, A Fair and Efficient Corporate Tax System in the European Union, SWD (2015) 121 final.

(iv) The nature of the elements of the allocation key/apportionment mechanism included in the Proposals, which some Member States feel would lead to more tax revenue flowing to the larger Member States, to the detriment of the smaller Member States; and

(v) The impact that the Proposals could potentially have on the Member States' bilateral tax treaties (the Proposals implying, in essence, a departure from the arm's-length principle, while that principle would continue to play a key role in tax treaties).

Against this backdrop, in its May 18, 2021 Communication to the European Parliament and the Council entitled "Business Taxation for the 21st Century,"⁶⁸⁵ the Commission announced that the pending C(C)CTB Proposals would be withdrawn and replaced by a proposal for a new framework for income taxation for businesses in Europe, to be known as "Business in Europe: Framework for Income Taxation" or "BEFIT." The Communication tabled a Commission proposal for BEFIT for 2023. Consistent with this timetable, on September 12, 2023, the Commission issued its Proposal for a Council Directive on BEFIT (the "BEFIT Proposal").⁶⁸⁶

The Explanatory Memorandum to the BEFIT Proposal emphasizes that the valuable insights and analyses gained from the many years of negotiations, particularly in the context of the 2011 and 2016 C(C)CTB proposals, could now be used in the design of BEFIT, having due regard to the changes in the modern economy characterized by increasing globalization and digitalization. For this reason, Worksheet 2.I sets out a cursory overview of the C(C)CTB Proposals.

The BEFIT Proposal also builds on the developments and achievements of Pillars One and Two at the OECD level.

⁶⁸⁵ https://taxation-customs.ec.europa.eu/system/files/2021-05/communication_on_business_taxation_for_the_21st_century.pdf.

⁶⁸⁶ Proposal for a Council Directive on Business in Europe: Framework for Income Taxation (BEFIT) {SWD (2023) 308 final} — {SWD (2023) 309 final}; COM (2023) 532 final; 2023/0321 (CNS). The BEFIT Proposal was preceded by both public and targeted consultations. For the public consultation, a call for evidence for an impact assessment (Ares (2022)7086603) and an online survey were published on October 13, 2022, followed by a consultation period of 12 weeks that ran until January 26, 2023. The aim of the public consultation was to collect views from stakeholders on: (i) the problem and the need to act; (ii) the scope of the new system; (iii) how to calculate the common tax base; (iv) how to consolidate the tax bases of group members and allocate the consolidated tax base to the eligible Member States; (v) how to allocate profit in the context of transactions between members of the group and entities outside the group (in the European Union and in non-EU countries); and (vi) how to simplify the administration of the system. Overall, the consultation received 123 contributions, consisting of 46 feedback contributions and 77 responses to the public consultation survey, of which 29 included written submissions that were either attached to feedback or sent by email. Fifty four out of the 123 contributions were submitted by businesses associations that represent general business interests, tax advisers, lawyers, or specific business sectors, such as insurance. Respondents also included citizens and both larger and smaller businesses, as well as academic and research institutions, non-governmental organizations, and trade unions. No input was received from any national authorities. Targeted consultations and bilateral meetings with relevant stakeholders (corporate taxpayers likely falling under BEFIT, academics, Member States) also took place. Member States were informed through meetings of the Commission Working Party IV (direct taxation) and the Council High-Level Working Party (HLWP).

B. Overview

The BEFIT Proposal seeks to introduce a common framework for corporate income taxation in the European Union by replacing the (currently) 27 different approaches to determining the taxable base of corporate groups with annual combined revenues exceeding 750 million euros.

The common framework is intended to:

- (i) Create a level playing field;
- (ii) Enhance legal certainty;
- (iii) Reduce compliance costs;
- (iv) Encourage businesses to operate cross-border; and
- (v) Stimulate investment and growth in the European Union.

According to the Commission, the BEFIT Proposal is fully consistent with existing EU policies in the field of direct taxation, such as:

- (i) The Merger Directive (see III., above);
- (ii) The Parent-Subsidiary Directive (see IV., above);
- (iii) The Interest and Royalty Directive (see V., above);
- (iv) The Directive on Administrative Cooperation (DAC) (in particular, DAC 4 on country-by-country reporting — see XXI.E., below); and
- (v) The Anti-Tax Avoidance Directive (ATAD) (see VI., above).

The only provision where the BEFIT Proposal needs to ensure consistency is the interest limitation rule (Article 4 of ATAD 1), which the BEFIT Proposal tries to achieve by accommodating this measure within the dimension of a cross-border group and not as a rule that will apply on a company-by-company basis (see Article 13 of the BEFIT Proposal, discussed at X.D.3., below).

The impact assessment report on the BEFIT Proposal examined three versions of BEFIT, i.e., three combinations of the various options:

- (i) Version 1 proposed a comprehensive set of rules, mandatory for all in-scope groups, for tax base computation purposes, linked to a tax base allocation based on a formula that includes intangible assets and an advanced one-stop-shop for administration purposes. It would involve the highest degree of harmonization and immediate application as well as ensuring the broadest scope possible and, as a result, the most extensive simplification for businesses in the European Union and Member State tax authorities.
- (ii) Version 2 proposed a BEFIT "light" approach, under which the rules are mostly optional for groups, with limited tax adjustments for tax base computation purposes, a gradual transitional tax base allocation and a limited one-stop-shop for administration purposes. It would achieve the least degree of harmonization.

(iii) Version 3 proposed a BEFIT “composite” as an “in-between” approach, setting out a hybrid scope of application, i.e., elements of both mandatory and optional application, combined with limited tax adjustments for tax base computation purposes, a gradual transitional tax base allocation rule and a limited one-stop-shop for administration purposes.

The impact assessment report concluded that Version 3 was the preferred policy package. It proved effective in achieving the specific objectives of the initiative and demonstrated efficiency in that:

(i) Its limited mandatory scope was carefully delineated to include solely those groups that could:

- Benefit from the common rules; and
- Afford the transition; and

(ii) It remained optional for groups below the threshold.

The BEFIT Proposal follows this conclusion.

Note: Together with the BEFIT Proposal, on September 12, 2023, the Commission adopted conjunctive yet separate proposals for a directive establishing a head office tax system for micro, small and medium sized enterprises (see XI., below).

C. Scope of Application

Under the general provisions of Chapter I of the BEFIT Proposal, the scope of application is a hybrid of mandatory and optional application.

The mandatory scope comprises the same corporate groups as the OECD’s Pillar Two (i.e., groups with annual combined revenues of at least 750 million euros) but is limited to the EU sub-set of entities that meet the 75% ownership threshold (see Articles 5–6).

For groups headquartered in third countries, the EU sub-set will need additionally to generate at least 50 million euros annual combined revenues in at least two of the four fiscal years immediately preceding the fiscal year in which the group starts to apply the BEFIT Directive (once adopted) and this will have to account for at least 5% of the total revenues of the group (Article 2, paragraph 4). The choice to align the mandatory scope with Pillar Two was made with the knowledge that in-scope taxpayers would already have implemented a number of the relevant features as part of the EU’s Pillar Two Directive.⁶⁸⁷

Comment: While, as indicated, the 750 million euros threshold has intentionally been aligned with the Pillar Two threshold to help ease compliance, the composition of the group that the threshold is tested against is not the same. The BEFIT group uses a 75% ownership test, whereas the Pillar Two definition of “group” is based on the accounting consolidation, which generally requires control (more than 50%). This, together with the additional threshold for groups headquartered in third countries, means that if a taxpayer falls within the scope of Pillar Two it does not necessarily follow that BEFIT will also apply to it. Separate computations may need to be per-

formed to determine if a group subject to the Pillar Two Directive is also in-scope of BEFIT.

Other, smaller groups (including SME groups) can opt into BEFIT, should they wish to do so, provided they prepare consolidated financial statements.

When a group applies or chooses to apply the rules of the BEFIT Proposal, the framework will apply to the whole “BEFIT group,” i.e., the sub-set of all EU tax resident companies and EU-located permanent establishments (PEs) of the group that meet the 75% ownership threshold (referred to as the “BEFIT group members”).

Under the BEFIT Proposal, an in-scope company or PE ceases to be subject to the national corporate tax laws of all the Member States in which it is established with respect to all matters regulated by the Proposal, unless otherwise stated therein.

Importantly, the BEFIT Proposal does not exclude any industry sectors from its scope. Rather, sector-specific characteristics are reflected in the relevant parts of the Proposal. In particular, this is the case for international transport and extractive activities. For example, the BEFIT Proposal carves out shipping income covered by a tonnage tax regime from the BEFIT tax base. Extractive activities are subject to tax in the country of origin (i.e., the place of extraction) and, hence, are excluded from the BEFIT tax base.

D. Calculation of Preliminary Tax Result

1. Overview

Chapter II of the BEFIT Proposal includes the rules for the determination of the preliminary tax result of each member of a BEFIT group. This is done by applying the Sections 2 and 3 adjustments and the rules in Section 4 on timing and quantification issues to the starting point, i.e., the net income or loss as stated in the financial accounts. Section 5 provides detailed rules on entities entering and leaving a BEFIT group and the impact of BEFIT on business reorganizations.

2. Starting Point

As in the case of the OECD’s Pillar Two, the starting point is the accounting result in the financial accounts, as determined using a single accounting standard for the BEFIT group. To this end, the financial accounts of each BEFIT group member must be reconciled with the accounting standard of the ultimate parent entity or, if the group is headquartered outside the EU, the accounting standard of the filing entity. The accounting standard applied must be one that is accepted under EU law, which essentially means it must either be the national generally accepted accounting principles (GAAP) of one of the Member States or the international financing reporting standards (IFRS) (Article 7).

3. Adjustments

The BEFIT adjustments concern items to be included in and excluded from the starting point, i.e., the financial accounting net income or loss.

⁶⁸⁷ On the Pillar Two Directive, see the discussion at VII., above.

Subtracted from Financial Net Income	Added to Financial Net Income
• Dividends (Article 8) • Capital gains (Article 9) • Changes in fair value (Article 10) • Profit/loss from PEs (Article 12) • Shipping income (Article 15) • Rollover relief for gains on assets that are replaced (Article 18) • Costs of and subsidies with respect to fixed depreciable assets (Article 19) • Currency exchange movements (Article 20) • Post allocation adjustments (Articles 21 and 48)	• Financial assets held for trading (Article 11) • Exceeding borrowing costs (Article 13) (i.e. borrowing costs that exceed the amount allowed under the ATAD interest limitation rule) • Fair value adjustments and capital gains realized by insurance undertakings (Article 14) • Fines, penalties and illegal payments, such as bribes (Article 16) • Corporate taxes, including top-up taxes paid under Pillar Two (Article 17)

Note: The financial net income is further adjusted by depreciation (see, 4. , below)

Items to be included, i.e., to be added back if they were deducted or are not already recorded in the financial accounting statements, relate to:

- (i) Financial assets held for trading (Article 11);
- (ii) Borrowing costs paid to parties outside the BEFIT group in excess of the amount allowed under the ATAD interest limitation rule (Article 13);
- (iii) Fair value adjustments and capital gains realized by life insurance undertakings in the context of unit-linked/index-linked contracts (Article 14);
- (iv) Fines, penalties and illegal payments such as bribes (Article 16); and
- (v) Corporate taxes already paid or top-up taxes paid in application of the OECD's Pillar Two (Article 17).

The following items are to be excluded, i.e., subtracted from the financial net income or loss if they were in the financial accounts:

- (i) Dividends and capital gains or losses on shares or ownership interests, where the ownership interest is significant and unless the shares/interest are held for trading purposes or by a life insurance undertaking (Articles 8–11 and Article 14);
- (ii) Profits or losses from PEs (Article 12);

(iii) Shipping income subject to a national tonnage tax regime (Article 15);

(iv) Rollover relief for gains on assets that are replaced (Article 18);

(v) Acquisition, construction and improvement costs of depreciable assets, because these costs will already be part of the depreciation base, as well as subsidies directly linked to this, because subsidies should be in neither the depreciation nor the tax base (Article 19); and

(vi) Unrealized gains or losses from currency exchange fluctuations with respect to fixed assets (Article 20). The rule in Article 21 also excludes any amount relating to the post-allocation adjustments listed in Article 48 (see below).

Comment: There are fewer adjustments under BEFIT than under the Pillar Two Directive (see VII.D., above). According to the Commission, this is because Pillar Two has a different purpose, namely, to calculate the appropriate qualifying income for the tax due. In addition, the BEFIT adjustments do not perfectly align with the Pillar Two adjustments.

Example: The BEFIT Proposal provides for an adjustment in relation to ownership interests to exclude:

- 95% of dividends or distributions (Article 8);
- 95% of gains or losses on disposition (Article 9); and
- 100% of fair value gains or losses (Article 10).

In each case, the ownership interests must have been held for over a year and must carry a right to more than 10% of profits, capital, reserves or voting rights.

While the 10% threshold is also a requirement under Pillar Two, the one-year holding period applies only to “excluded dividends” (the Pillar Two equivalent of Article 8); it does not apply to “excluded equity gains or losses” (the Pillar Two equivalent of Articles 9 and 10).

In addition, while, under Pillar Two, the adjustment is for 100% of dividends, or gains or losses on disposition, it is limited to 95% of dividends, etc. under Articles 8 and 9 of the BEFIT Proposal (but not under Article 10 where the adjustment is for 100% of the relevant fair value gain or loss).

As such, computations separate from and additional to those required for Pillar Two purposes may need to be performed for BEFIT purposes.

4. Common Set of Tax Depreciation Rules

Section 3 of the proposal sets out a common set of tax depreciation rules.

Fixed tangible assets valued at under 5,000 euros are immediately expensed. Other assets are always depreciated on a straight-line basis over the duration of the underlying asset, which corresponds, in principle, to the asset's useful life in the financial accounts. However, as a rule, the duration is set at 28 years for immovable property, including industrial buildings.

For fixed intangible assets, the duration corresponds to the applicable period of legal protection offered (for example, by intellectual property rights) or, if that does not apply, five years.

Goodwill is also depreciated if it is acquired, and, accordingly, reflected in the financial accounts.

5. *Timing and Quantification Issues*

Section 4 of the proposal contains timing and quantification rules for tax purposes that are designed to prevent abuse:

- (i) Differences between the cost of stock and work-in-progress must be measured consistently using the first-in-first-out (FIFO) method or the weighted average cost method (Article 29).
- (ii) Provisions are prohibited if they are not legally required or cannot be reliably estimated (Article 30).
- (iii) Bad debts can only be deducted if all reasonable steps to obtain payment from the debtor have been exhausted or if the amount that will be lost can be reliably estimated. Bad debts can never be deducted if the debtor is an associated enterprise (Article 31).
- (iv) Revenues and costs related to long-term contracts only count in the year in which they accrued or were incurred (Article 32).
- (v) The treatment of hedging instruments must follow the tax treatment of the hedged items (Article 33).

6. *BEFIT Group Changes and Business Reorganizations*

Section 5 of the proposal includes rules applicable to entities entering or leaving a BEFIT group. For example, losses incurred before a new member enters a BEFIT group should not be included at the expense of the tax base of other Member States in which members of the BEFIT group are located. These losses should be set off against the allocated share, i.e., after aggregation and allocation (Article 38 in conjunction with 48, paragraph 1(a) of the BEFIT Proposal).

The rules also deal with business reorganizations, indicating that the Merger Directive takes precedence (Article 40).

Finally, an anti-abuse rule should ensure that capital gains with respect to assets are included in the preliminary tax result when the assets are moved within the group, with no tax implications, to a group member that is subsequently sold out of the group. Such an operation would normally benefit from a tax exemption for share disposals but such an exemption would not be granted, unless it could be justified from a commercial perspective (Article 41).

E. *Aggregation of Preliminary Tax Results and Allocation of Aggregated Tax Base*

Chapter III of the BEFIT Proposal contains the rules for the aggregation and allocation of the tax base to eligible BEFIT group members.

1. *Aggregation of Preliminary Tax Results into BEFIT Tax Base*

To determine the BEFIT tax base, the preliminary tax results of all members of the BEFIT group are aggregated into a single “pool” at EU group level. This constitutes the “BEFIT tax base” (Articles 42–44).

According to the Explanatory Memorandum, such aggregation should:

- (i) Allow for cross-border loss relief;
- (ii) Facilitate transfer pricing compliance (during the transitional period, BEFIT group members will be deemed to comply with the arm’s length principle if, as a result of their intra-BEFIT group transactions, their expenses or income remain within a limit of a less than 10% increase compared to the average of the previous three fiscal years; conversely, any increase beyond the 10% threshold will not be recognized when computing the baseline allocation percentage); and
- (iii) Eliminate the levying of withholding taxes on transactions such as interest and royalty payments within the BEFIT group, provided the beneficial owner of the payment is a BEFIT group member.

There are two exceptions to the aggregation rules:

- (i) Income and losses from extractive activities are separated from the BEFIT tax base. The rationale, in line with the OECD/G20 Inclusive Framework Two-Pillar Approach, is that these activities should be taxed at their place of origin, i.e., the place of extraction (Article 46).

- (ii) Revenues and expenses from:

- Shipping activities that are not covered by a tonnage tax regime; or
- Air transport activities

are also not allocated. In line with the approach set out in Article 8 of the OECD Model Tax Convention, such activities are taxed only in the State where the company operating the ships or aircraft is located (Article 47).

2. *Allocation of BEFIT Tax Base to BEFIT Group Members*

In the first seven years of the post-implementation (transitional) phase, the BEFIT tax base is to be allocated to each BEFIT group member based on a baseline allocation percentage, calculated using their percentage of the average taxable results in the prior three fiscal years.⁶⁸⁸

⁶⁸⁸ In proposing a transitional base line allocation percentage, the BEFIT Proposal departs from the allocation of profits to Member States based on a pre-defined formula (formulary apportionment) as was suggested in the 2022 consultation documents. The latter had explored options for an allocation based on allocation factors such as tangible assets (excluding financial assets), labor (possibly a combination of staff numbers and payroll) and sales by destination, as well as intangible assets.

$$\text{Allocable share (t1)} = \frac{\text{Average taxable result of the BEFIT group member (t0, t-1, t-2)}}{\text{Average taxable result of the BEFIT group (t0, t-1, t-2)}} \times \text{BEFIT tax base (t1)}$$

In the first fiscal year in which a BEFIT group is subject to the BEFIT framework (t1), the prior year taxable results (t0) would need to be determined in accordance with the national corporate tax rules of the Member State in which the BEFIT group member is resident or situated for tax purposes.

In subsequent fiscal years (for example, t2), the calculation of the prior year taxable result (for example, t1) would generally need to be based on the BEFIT provisions for calculating the preliminary tax result of the BEFIT group member.

The BEFIT Proposal makes it clear that where a BEFIT group member has negative taxable results, the baseline allocation percentage for the respective BEFIT group member would be deemed to be zero. In addition, the Proposal provides that adjustments to the allocation percentage would be required for intra-BEFIT group transactions that are not priced at arm's length. Other adjustments that need to be made to the baseline allocation percentage of a BEFIT group member include:

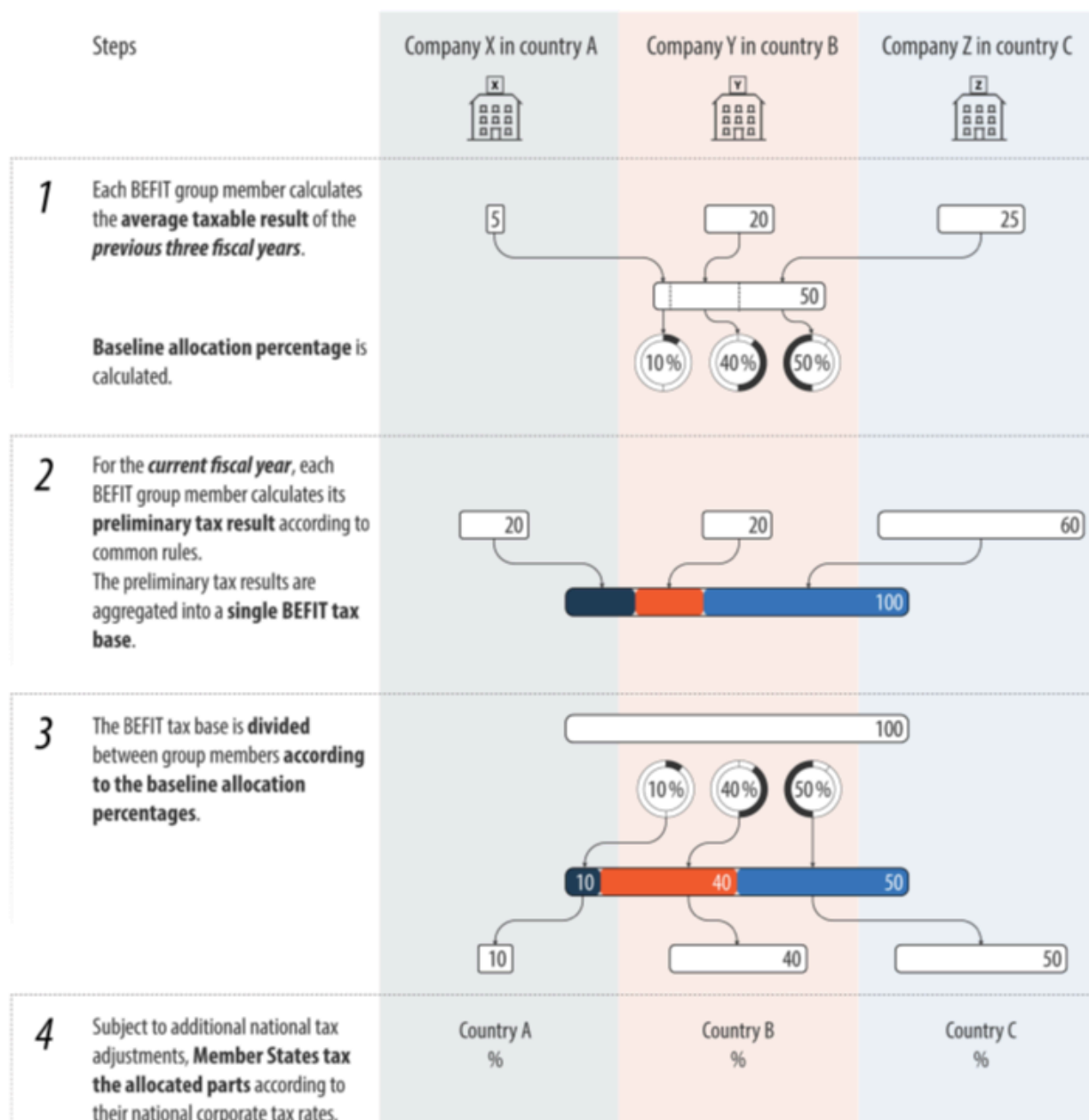
(i) Deduction limitations for exceeding borrowing costs that arise from a transaction between BEFIT group members; and

(ii) Re-calculation requirements in the case of BEFIT group members joining or leaving the group.

The Explanatory Memorandum notes that this allocation approach may pave the way for a permanent allocation method that could be based on formulary apportionment.⁶⁸⁹ The Commission may propose the introduction of full formulary apportionment using substantive factors by way of a directive before 2035.

⁶⁸⁹ According to Recital 12 of the BEFIT Proposal: “[such a] permanent mechanism could be based on a formulary apportionment and would render the need for intra-BEFIT group transactions to be consistent with the arm's length principle redundant. It would have the advantage of using more recent country-by-country reporting ('CbCR') data and the information gathered during the transition period. This will also allow for a more thorough assessment of the impact that the implementation of the two-pillar approach is expected to have on national tax bases and the BEFIT group tax bases. In this way, it would still become possible to materialise the key objective of tax neutrality in the internal market, which would reduce instances of double and over-taxation and enhance tax certainty with the aim of reducing the number of tax disputes”.

Allocation of the BEFIT tax base: Example



3. Local Adjustments to Allocated Tax Results

On allocation, each BEFIT group member will be required to make additional local adjustments to its part of the taxable base (for example, for pre-BEFIT losses, pension provisions, etc.) (Article 48, paragraph 1).

In particular, the BEFIT Proposal provides for local adjustments with respect to distribution-based tax systems (i.e., where the taxation of corporate income is not assessed on an annual basis, but only when profits are distributed), under which the allocated part of the aggregated tax base would be carried forward each year in proportion to the undistributed income (Article 49).

In addition, to ensure their full control over their tax rate policies, Member States will be free to apply any deductions, tax incentives, or base increases to their allocated parts without

restriction — provided, however, that such local adjustments are OECD Pillar Two compliant (Article 48, paragraph 2).

The BEFIT Proposal also requires Member States to grant foreign tax credits (i.e., tax credits for taxes on a BEFIT group member's income imposed in another Member State or in a third country) in line with applicable tax treaties or national law and subject to certain conditions. The tax credit would then need to be shared among the BEFIT group members based on the respective baseline allocation percentage of each BEFIT group member.

Under BEFIT, tax rate and enforcement policies would remain within the jurisdiction of Member States.

F. “Traffic Light System” for Low-Risk Activities

With regard to transactions with associated enterprises outside the BEFIT group, i.e., entities of the group that are not in the European Union or that do not meet the 75% ownership threshold, Chapter IV of the BEFIT Proposal aims to facilitate compliance by providing a risk assessment tool (the “traffic light system”) with benchmarks. According to the Explanatory Memorandum, this feature of BEFIT focuses on simplifying compliance with transfer pricing rules and does not interfere with the substantive rules that determine whether a particular transaction has been priced at arm’s length. In addition, its material scope is confined to low-risk activities that normally do not involve extensive discretion in their pricing, as they do not give rise to high residual profits.

The traffic light system will apply to low-risk activities, as defined in Article 50, i.e.:

- (i) Distribution activities of low-risk distributors; and
- (ii) Manufacturing activities of contract manufacturers.

To qualify, the distributor or manufacturer:

- (i) Must use a reliable one-sided method based on the OECD Transfer Pricing Guidelines; and
- (ii) Cannot hold the intellectual property rights or bear any of the risks related to the products.

For these activities, the BEFIT Proposal suggests using “Public Benchmarks,” which will be profit markers set at EU level with the help of an expert group (Article 53).

Operationally, if the profit performance of a low-risk distributor or contract manufacturer is low compared to the average ranges in this benchmark, its transactions will be assessed as “high-risk” and so on.

Transactions should fall within one of three risk zone categories:

- (i) Low;
- (ii) Medium; or
- (iii) High.

Member States’ tax administrations would be expected to focus their efforts on the high-risk zones (Article 51), hence the reference to a “traffic light system.”

G. BEFIT System Administration: “One-Stop-Shop” and “BEFIT Team”

Chapter V of the BEFIT Proposal outlines how the BEFIT system is to be administered.

A one-stop-shop should allow businesses to deal with a single authority in the European Union with respect to their filing obligations.

- (i) The “filing entity,” in principle, the ultimate parent entity, will file one information return for the whole BEFIT group (the “BEFIT Information Return”) with only its own tax administration (the “filing authority”), which will share this with the other Member States in which the group operates (Article 57).
- (ii) Each BEFIT group member will also file an individual tax return with its local tax administration to allow it to ap-

ply domestically set adjustments to its allocated part (Article 62). Taken together with the BEFIT Information Return, this should allow each tax administration to assess its BEFIT group members’ tax liabilities (Article 64).

For each BEFIT group, there will also be a designated “BEFIT Team,” which will bring together representatives of each relevant tax administration from the Member States in which the group operates (Article 60). Instead of each Member State separately dedicating human resources to assess the tax liabilities of the cross-border group, the members of the BEFIT Team will be:

- (i) Sharing information;
- (ii) Coordinating;
- (iii) Providing a degree of early certainty on specific topics; and
- (iv) Resolving issues through an online collaborative tool (Article 61).

Audits will continue to be conducted at the level of the Member States. It will also be possible for Member States to request joint audits and create an obligation on the other side to accept such requests. Following the outcome of an audit, the BEFIT Team would also facilitate rectifications (Article 65).

Appeals against the content of the BEFIT Information Return may be brought to an administrative body in the Member State of the “filing authority.” Likewise, appeals against the individual tax assessments may be brought to an administrative body of the Member State in which the BEFIT group member is resident for tax purposes. Judicial appeals on BEFIT Information Returns and individual tax assessments are to be made to the Member State of the relevant entity. When such appeals affect the BEFIT tax base, the necessary amendments can be made across the group through a coordinated process established by the competent BEFIT Team. (Articles 66–70).

H. Penalties

Member States are authorized to adopt domestic rules on penalties applicable to infringements of national provisions adopted pursuant to the BEFIT Directive (once adopted) and take all necessary measures to ensure that they are implemented and enforced. Penalties and compliance measures provided for must be effective, proportionate and dissuasive.

I. Transposition

If adopted as a directive, Member States are to adopt and publish the laws, regulations and administrative provisions necessary to comply with the BEFIT rules by January 1, 2028, and apply those provisions from July 1, 2028.

J. State of Play

Following an in-depth analysis instigated by the Belgian Presidency (January-June 2024), a detailed discussion took place in May 2024 mainly looking at potentially aligning the first 20 Articles of the BEFIT Proposal with the Pillar Two rules. In addition, further alignment with other pieces of EU legislation, such as the Accounting Directive, the Parent-Subsidiary Directive and the Interest and Royalty Directive, as well as with tax treaties is to be sought, which will take into account

the bearing of the relevant CJEU case law on the BEFIT Proposal as a whole.

While, reportedly, the technical analysis of the BEFIT Proposal continues, it is clear from the Hungarian presidency (July-December 2024) program that the BEFIT Proposal is not, as such, listed as one of the program's priorities or main directions.

Also, an apparently growing number of Member States are raising major concerns about the BEFIT Proposal in its current form. In the reasoned opinions submitted by the Czech Parliament (January 25, 2024), the Swedish Parliament (January 31, 2024), the Irish Houses of Oireachtas (February 13, 2024), the Maltese House of Representatives (February 16, 2024) and the Poland Senate (March 15, 2024), serious questions are raised as to the compatibility of the BEFIT Proposal with the principles of subsidiarity and proportionality and, ultimately, with the fiscal sovereignty of Member States. The Netherlands and Finland have raised similar concerns. In addition, Germany has expressed concerns that BEFIT would not achieve its objectives since its hybrid approach with regard to corporate income taxation would increase the administrative burden. Germany also wishes to ensure BEFIT would not cause a tax base shift detrimental to Germany.

Against this backdrop, unanimous consent (required to adopt the directive) seems far away and, in the same vein, adoption of the BEFIT Proposal through the potential use of the "enhanced cooperation procedure"⁶⁹⁰ would also seem unlikely. In the author's opinion, therefore, the future of the BEFIT Proposal is highly uncertain, unless its very basics are thoroughly revisited. The implementation date of July 1, 2028 initially contemplated therefore seems illusory.

Despite the foregoing, in Annex III to its 2025 Work Program, the EU Commission lists the BEFIT Proposal as "pending," suggesting continuation of work on this initiative in the course of 2026. On September 24, 2025, the European Parliament's Economic and Monetary Affairs Committee adopted its position on the BEFIT Proposal, bringing the following additions to the proposed legislation:⁶⁹¹

⁶⁹⁰ Under the Treaty, enhanced cooperation may only be adopted as a last resort when the Council has established that the objectives of the cooperation cannot be achieved by the European Union as a whole within a reasonable time. Enhanced cooperation must be intended to further the objectives of the Union, protect its interests and reinforce its integration process. At least nine Member States must participate. Others may join at a later stage. Enhanced cooperation must not undermine the internal market or the economic, social and territorial cohesion of the European Union. It must not constitute a barrier to, or discrimination in, trade between Member States, nor may it distort competition between them. It must respect the competencies, rights and obligations of non-participating Member States. Although legislation adopted by enhanced cooperation only binds participating Member States, it does form part of the EU *acquis* and can have a knock-on effect on non-participating Member States. Enhanced cooperation is based on TEU, Art. 20, and the detailed rules set out in TFEU, Part VI, Title III (Arts. 326 *et seq.*).

⁶⁹¹ <https://www.europarl.europa.eu/news/en/press-room/20250922IPR30508/befit-tax-base-standard-meps-adopt-their-position-in-committee>.

(i) Addition of a "significant economic presence clause" stating that companies having more than 1 million euros in revenues in a Member State will be permanently established there. According to the Committee, this clause would help identify which Member States should be considered for the apportionment of tax that multinationals need to pay in the European Union. It would also ensure that digital companies pay taxes in the jurisdictions where they are effectively making profits, whether by providing services or selling products, irrespective of whether they have an important physical presence there.

(ii) Introduction of a royalties limitation rule for companies forming part of a BEFIT group. If a company in such a group pays royalties or license fees to another group company that is taxed at a rate of less than 9%, the paying company must add those payments back to its own taxable income. This is unless the recipient company carries out substantive economic activity supported by staff, equipment and offices.

(iii) Introduction of a rule to prevent companies from shifting profits to foreign subsidiaries in low-tax jurisdictions that do not carry on any real economic activity. If such subsidiaries earn only passive income (such as interest or royalties) and do not carry on any real economic activity, that income would have to be added to the parent company's taxable income.

(iv) Introduction of faster tax write-offs for certain assets that support EU climate, social, digital or defense goals to help encourage investment, achieving a sustainable transition and enhancing the European Union's ability to prevent and respond to emerging threats and crises.

(v) Prevention of abuse with respect to potential losses. If a subsidiary's loss creates a negative taxable amount, the parent company can use it to reduce its own taxable income but only for up to five years, the loss being set off against the next positive BEFIT tax base. The eventual tax deductions cannot reduce the company's taxable income to less than zero.

The Committee's amendments to the Commission BEFIT Proposal were put to a plenary vote on November 13, 2025 where they were adopted by 370 votes to 160, with 107 abstentions. The position has been submitted to the EU Council which can either accept or amend the Parliament's position (which would mean adoption of the BEFIT Proposal in the former case, or the opening of a second reading in the EU Parliament and subsequently the Council in the latter case). The directive requires the unanimous approval of all Member States and the application date for the rules, if adopted, is targeted for July 1, 2028.

XI. Head Office Tax System Proposal

A. General

Executive Summary

This Section discusses the Head Office Tax System or HOT Proposal under which an SME that opted in would be able to calculate the taxable result of its qualifying PEs in accordance with the tax laws of the Member State of the head office, thereby reducing its overall tax compliance burden.

In the 2025 Work Program, the EU Commission lists the HOT Proposal as “pending”.

On September 12, 2023, the Commission adopted a Proposal for a Council Directive establishing a Head Office Tax system for micro, small and medium sized enterprises (the “Head Office Tax System Proposal” or “HOT Proposal”).⁶⁹² The HOT Proposal should be considered in conjunction with the BEFIT Proposal, issued on the same date (see X., above).⁶⁹³

According to the Explanatory Memorandum, the current systems of business taxation in the European Union give rise to a significant degree of complexity. This translates into:

- (i) Businesses facing high compliance costs;
- (ii) Barriers to cross-border operations; and
- (iii) The risk of double and/or over-taxation leading to tax uncertainty and frequent, time-consuming legal disputes.

These setbacks constitute a proportionately higher burden for SMEs than they do for large groups of companies. SMEs spend approximately 2.5% of their turnover on ensuring compliance with their tax obligations, while large enterprises, leveraging economies of scale, spend only 0.7%.

An SME operating cross-border becomes taxable in more than one Member State as soon as its activity abroad creates a permanent establishment (PE). Compliance with the ensuing obligations comes with fixed costs, creating a barrier that may prevent SMEs from developing their business internationally. This is especially the case in the initial stages of business expansion when the extent of activities carried on abroad would mainly be ancillary to the primary business operations in the state of origin. It is thus important that SMEs that envisage growing and expanding across borders through PEs can continue to apply the tax rules they are familiar with in calculating the taxable results of their PEs in other Member States.

Specifically, under the HOT Proposal, the taxable result of each PE of an eligible SME could be calculated in accordance with the tax laws of the Member State of the head office. To prevent circumvention, the rules are coupled with the require-

ment that an opting-in SME would be obliged to apply the rules of the state of the head office for a (renewable) minimum period of time.⁶⁹⁴

The simplified approach referred to as “Head Office Taxation” is limited to the tax rules for the computation of the taxable results of PEs and does not touch upon the social security rules applied in the Member State of the PE, nor does it affect existing tax treaties.

B. Detailed Proposal

As indicated above, the scope of the Head Office Tax System Proposal is limited to standalone SMEs that operate exclusively through PEs in one or more Member States (Article 2).

Under the Proposal, eligible SMEs include SMEs:

- (i) Established under the law of a Member State and taking one of the forms listed in Annexes I and II to the Proposal;
- (ii) Resident for tax purposes in a Member State in accordance with the tax laws of that Member State, including that Member State’s tax treaties;
- (iii) Subject, directly or at the level of their owners, to a tax on profits listed in Annexes III and IV to the Proposal, or to any other tax with similar characteristics;
- (iv) Qualifying as micro or small and medium-sized (SMEs), as defined in Directive 2013/34/EU on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings;
- (v) Operating in other Member States exclusively through one or more PEs; and
- (vi) Not being part of a consolidated group for financial accounting purposes and constituting an autonomous enterprise that is not:

- An associated enterprise within the meaning of Article 2(13) of Directive 2013/34/EU; or
- A linked enterprise within the meaning of Article 3(3) of Commission Recommendation 2003/361/EC concerning the definition of micro, small and medium-sized enterprises.

Head offices with income from shipping activities subject to a tonnage tax regime in the head office Member State are excluded from applying the head office taxation rules with respect to their PEs in other Member States to the extent these derive income from shipping activities.

Under the Proposal, eligible SMEs have the option of calculating the taxable result(s) of their PE(s) based only on the tax rules of the Member State of their head office, while the applicable tax rate(s) will remain that/those of the Member State(s) where the PE(s) is/are located.

⁶⁹² Proposal for a Council Directive establishing a Head Office Tax system for micro, small and medium sized enterprises, and amending Directive 2011/16/EU, {SEC(2023) 308 final} — {SWD(2023) 301 final} — {SWD(2023) 302 final} — {SWD(2023) 303 final}; COM(2023) 528 final 2023/0320 (CNS).

⁶⁹³ See the May 18, 2021 Communication to the European Parliament and the Council entitled “Business Taxation for the 21st Century”: https://taxation-customs.ec.europa.eu/system/files/2021-05/communication_on_business_taxation_for_the_21st_century.pdf.

⁶⁹⁴ The Head Office Tax System Proposal hereby follows Option 1 of its accompanying Impact Assessment Report. Other options set out in the Report included maintaining the status quo (Baseline option) and an optional head office tax system for SMEs with PEs and subsidiaries (Option 2), extending the scope of application to also include groups of entities. The analysis of the technical elements of Option 2 is essentially the same as under Option 1, but the implications are different, depending on whether the common rules are applied to subsidiaries or PEs, as the former are separate legal persons whilst PEs are part of the same legal entity as the head office.

The option lasts for five years (Article 7), unless:

- (i) The head office changes residence; or
- (ii) The joint turnover of the PEs becomes at least triple of the head office's turnover,

in which case the head office tax rules cease to apply.

At the end of each five-year period, an SME will be entitled to renew its choice for another five years, without limit, provided it continues to meet the eligibility requirements (Article 9). However, when a standalone SME decides to set up a subsidiary, or the joint turnover of its PEs becomes at least double of the head office's turnover, or when it ceases to qualify as an SME altogether, it cannot renew application of the head office tax rules when the five-year period expires (Article 10).

A one-stop shop is designed to enable an in-scope SME to interact only with the tax administration of the Member State of its head office in relation to the opt in procedure, filing obligations and the payment of taxes (Articles 6, 9, 11 and 14).

The "filing entity" for all PEs is the head office of the SME. An SME will thus file a single tax return with the tax administration of its head office (the "filing authority") (Article 11). This tax administration will subsequently transfer the resulting tax revenues to each Member State where the SME maintains a PE (Article 14). The Member State of the head office will apply the rates applicable in the Member State(s) where the SME maintains PEs and, subsequently, transfer the resulting tax revenues to the latter (Article 12).

The exchange of information between the tax authorities concerned is to take place under the existing DAC framework (see XXI., below).

Each Member State will remain competent for audits of PEs in its jurisdiction and will be able to request joint audits that create an obligation to engage for the other Member State concerned (Article 13).

According to the Proposal, if the Proposal were to be adopted as a Directive, the Member States would be required to adopt and publish the measures necessary to comply with the Directive by December 31, 2025 and apply those measures from January 1, 2026 onwards.

C. State of Play

On April 10, 2024, the European Parliament adopted its (non-binding) resolution on the HOT Proposal.⁶⁹⁵ The resolution strongly supports the overall proposal and underlines the serious need to reduce tax compliance costs for SMEs. To enable more companies to benefit from the simplifications, the resolution proposes to extend the scope of the HOT system to companies that operate through no more than two subsidiaries (along with companies operating exclusively through PEs). It also asks for an advanced roll-out, with HOT to apply from January 2025 (rather than 2026).

In June 2024, the Council took stock of the file's state-of-play. While some Member States see room for further technical discussions on the basis of the HOT Proposal, a large number of delegations have raised serious concerns as regards a number of aspects of the Proposal. These include the administrative or aggressive tax planning challenges that it may create for tax authorities, concerns about the potential effect on tax revenues of Member States, risks linked to the competitiveness of domestic markets ("home" SMEs that choose not to or cannot expand cross-border), as well as more general aspects linked to the burden on national tax systems and to tax sovereignty. A number of Member States hold the view that a more general (orientation) discussion on this file is needed before any further technical progress can be made. Further work on this file could therefore continue with the objective of preparing a high-level discussion on the policy choices that would need to be made with regard to the HOT Proposal.

In Annex III to its 2025 Work Program, the EU Commission lists the HOT Proposal as "pending", suggesting continuation of work on this initiative in the course of 2025.

⁶⁹⁵ European Parliament legislative resolution of April 10, 2024 on the proposal for a Council directive establishing a Head Office Tax system for micro, small and medium sized enterprises, and amending Directive 2011/16/EU (COM(2023)0528 – C9-0340/2023 – 2023/0320(CNS)).

XII. Arbitration Convention and Double Taxation Dispute Resolution Mechanisms

A. General

Executive Summary

This Section is intended to provide an overview of instruments developed at the EU level to eliminate double taxation. On the one hand, the Arbitration Convention sets out procedures for resolving situations in which Member States cannot reach mutual agreement on the equitable elimination of double taxation arising as a result of adjustments of profits between companies located in two or more Member States (see XII.B., below). On the other hand, given the flaws that have been identified in it, the Arbitration Convention has been supplemented by the Double Taxation Dispute Resolution Mechanisms Directive, which broadens the scope of the Arbitration Convention to encompass other areas and is intended to resolve the perceived shortcomings of that Convention (see XII.C., below).

The Arbitration Convention (see XII.B., below) provides a detailed set of procedures to be followed in situations where Member States cannot reach mutual agreement on the equitable elimination of double taxation arising as a result of adjustments of profits between companies located in two or more Member States (for example, following a review of transfer pricing documentation).

The Double Taxation Dispute Resolution Mechanisms Directive (the “DRM Directive,” see XII.C., below) builds on the Arbitration Convention, broadening its scope to other areas and introducing targeted features to address the main shortcomings identified (for example, by enhancing the enforceability and effectiveness of the mechanism). The DRM Directive does not replace the Arbitration Convention but exists “in addition” to it.

B. Arbitration Convention

1. General

The Convention of July 23, 1990 on the elimination of double taxation in connection with the adjustment of profits of associated enterprises (the “Arbitration Convention”), potentially of crucial importance to multinationals, was originally proposed as a directive in 1976. It was subsequently reissued as both a directive and a convention. Eventually, as promulgated by the Council, it took the form of a multilateral convention.⁶⁹⁶

⁶⁹⁶ The Arbitration Convention was adopted based on EC Treaty, Art. 293, which provided that “Member States shall, so far as is necessary, enter into negotiations with each other with a view to securing for the benefit of their nationals (...) the abolition of double taxation within the Community.” The consequences of this are that the CJEU has no jurisdiction to interpret or enforce the Convention, that the Commission cannot initiate any action against Member States failing to comply with the Convention, and that the Convention does not of itself have direct effect in, and priority over, national law. EC Treaty, Art. 293 was repealed by the Lisbon treaty and, hence, was not reproduced in the TEU/TFEU.

The Arbitration Convention was ratified in 1994 by the (then) 12 Member States. At a later stage, the (then) new Member States (Austria, Finland and Sweden), acceded to the Convention.

The initial duration of the Convention was five years, which expired on December 31, 1999. In 1999, the Member States adopted a Protocol to the Arbitration Convention⁶⁹⁷ that:

- (i) Extended the term of the Arbitration Convention for additional five years; and
- (ii) Provided for an automatic five-year renewal system.

According to its terms, the Protocol was to take effect on January 1, 2000. However, it only entered into force on the first day of the third month following the deposit of the last instrument of ratification. Italy and Portugal were the last Member States to ratify the Protocol. As Portugal had deposited its instrument of ratification on July 29, 2004, and Italy on August 4, 2004, the Protocol entered into force on November 1, 2004, with retroactive effect from January 1, 2000.⁶⁹⁸

The Arbitration Convention provides a detailed set of procedures to be followed in situations where Member States cannot reach mutual agreement on the equitable elimination of double taxation arising as a result of adjustments of profits between companies located in two or more Member States (for example, following a review of transfer pricing documentation).

The procedures for resolving disputes involving transfer pricing adjustments are, in many cases, already provided for under the mutual agreement procedure (MAP) set out in bilateral tax treaties. The Arbitration Convention:

- (i) Provides a time limit within which the Contracting States must reach a solution; and
- (ii) In the absence of an agreement, imposes a binding solution on the relevant taxing authorities.

2. Scope of Application

The Arbitration Convention applies where, for the purposes of taxation, profits that are included in the profits of an enterprise of a Contracting State are also included or are also likely to be included in the profits of an enterprise of another Contracting State on the grounds that the principles set out in the Convention (notably in Article 4, see below) and applied either directly or in corresponding provisions of the law of the State concerned, have not been observed.⁶⁹⁹

However, the Convention also applies where any of the enterprises concerned have made losses rather than profits⁷⁰⁰ and effective double taxation will thus only arise in the future (i.e., on the full use of loss carryforwards).

⁶⁹⁷ Protocol of May 25, 1999 amending the Convention of July 23, 1990 on the elimination of double taxation in connection with the adjustment of profits of associated enterprises (1999/C 202/01).

⁶⁹⁸ All EU Member States have, therefore, signed the Arbitration Convention, but some have made reservations to one or more of the Convention’s provisions.

⁶⁹⁹ Arbitration Convention, Art. 1(1).

⁷⁰⁰ Arbitration Convention, Art. 1(3).

a. Territorial Scope

The territorial scope of the Arbitration Convention is defined in (what is now) Article 355 of the TFEU.⁷⁰¹

The Arbitration Convention applies a strict *situs*-based (territorial) criterion from which it follows that a PE situated in a non-Member State is excluded from the scope of application of the Convention, even if it is a PE of an EU-based enterprise. In the same vein, transfer pricing disputes relating to transactions between two PEs situated in non-Contracting States fall outside the scope of application of the Arbitration Convention, even if they are PEs of enterprises of two Member States. At the same time, as one of the basic conditions for the application of the Arbitration Convention is the involvement of (at least) two enterprises of (at least) two different Contracting States, transfer pricing disputes involving two associated enterprises based in the same Member State are also automatically excluded from its scope of application.

b. Material Scope — Taxes Covered

The Arbitration Convention applies to taxes on income,⁷⁰² “in particular” to the taxes listed in the Convention,⁷⁰³ as well as to any identical or similar taxes that are imposed after the date of signature of the Convention in addition to, or in place of, existing taxes.⁷⁰⁴

The use of the words “in particular” indicates that the list of (existing) taxes is not exhaustive. The list covers income taxes on individuals, companies, residents and nonresidents, principal taxes and surtaxes, but does not cover stamp duties, taxes imposed on a taxpayer’s wealth and other non-profit-based taxes. Though often calculated as a percentage of the amount of the adjustments in the context of which the Convention applies and making up an integral portion of such adjustments, penalties do not constitute income taxes or adjusted amounts included in both enterprises’ taxable profits, and therefore fall outside the scope of the Convention.

c. Personal Scope

The Arbitration Convention applies to situations in which profits that are included in the profits of “an enterprise of a Contracting State” are also included, or are likely also to be included, in the profits of an enterprise of another Contracting State. The Convention does not define the term “enterprise of a Contracting State” or the term “enterprise.” Any term not defined in the Convention has, unless the context otherwise requires, the meaning that it has under the tax treaty between the States concerned.⁷⁰⁵ As such, any such concept should be construed under the relevant treaty. Where such a treaty follows the OECD Model Tax Convention, the definitions are, respectively, “an enterprise carried on by a resident of a Contracting State” and “the carrying on of any business.” The term “business” is in turn taken to include “the performance of professional services and of other activities of an independent character.”

⁷⁰¹ Arbitration Convention, Art. 16(1). The exclusions set forth in Art. 16(2) are superseded by the text of TFEU, Art. 355.

⁷⁰² Arbitration Convention, Art. 2(1).

⁷⁰³ Arbitration Convention, Art. 2(2).

⁷⁰⁴ Arbitration Convention, Art. 2(3).

⁷⁰⁵ Arbitration Convention, Art. 3(2).

The connecting factor between an enterprise and a Contracting State is that of “residence” (likewise to be construed under the relevant tax treaty).

Furthermore, for the Arbitration Convention to apply, the enterprises concerned must be “associated.” Enterprises are “associated” where:

- (i) An enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of another Contracting State; or
- (ii) The same persons participate directly or indirectly in the management, control or capital of an enterprise of one Contracting State and an enterprise of another Contracting State.⁷⁰⁶

An enterprise and its PE are deemed to be distinct enterprises under a legal fiction, thus enabling them to fall within the scope of the Convention.⁷⁰⁷

d. “Serious Penalty” — Exclusion

The competent authority of a Contracting State is not obliged to initiate a MAP or to set up the advisory commission referred to below where legal or administrative proceedings have resulted in a final ruling that, because of actions giving rise to an adjustment of transfers of profits, one of the enterprises concerned is liable to a serious penalty.⁷⁰⁸

The Arbitration Convention does not define the concept of “serious penalty.” Instead, the article concerned is supplemented by unilateral declarations made by Member States to explain what they consider (under their respective domestic laws) to be a serious penalty, i.e., the Individual Declarations of the Contracting States on Article 8 annexed to the Convention. Regrettably, this has led to diverging interpretations regarding what constitutes a “serious penalty” for the purposes of the Arbitration Convention,⁷⁰⁹ potentially leaving Member States with a degree of discretionary power as to whether or not to apply the procedures set out in the Convention.⁷¹⁰

3. Arm’s-Length Criterion

The Arbitration Convention is predicated on the arm’s-length standard. Specifically, the Convention defines the following “principles” to be observed by the Contracting States when adjusting profits. These “principles” are the same as those set forth in the OECD Model Tax Convention:

- (i) First, where conditions are made or imposed between associated enterprises in their commercial or financial re-

⁷⁰⁶ Arbitration Convention, Art. 4(1)(a) and (b).

⁷⁰⁷ See Arbitration Convention, Art. 1(2): a PE of an enterprise of a Contracting State situated in another Contracting State is deemed to be an enterprise of the State in which it is situated.

⁷⁰⁸ Arbitration Convention, Art. 8(1). Where such judicial or administrative procedures are conducted simultaneously with the procedures under the Convention, the competent authorities may stay the procedures under the Convention until the judicial or administrative procedures are concluded (Arbitration Convention, Art. 8(2)).

⁷⁰⁹ For example, some Member States include only cases where there is *do-lus*, while other Member States also include cases of *culpa*.

⁷¹⁰ It is precisely for this reason that the 2009 Revised Code of Conduct recommends that Member States should clarify or revise their unilateral declarations in the Annex to the Arbitration Convention to better reflect the position that a serious penalty should only be applied in exceptional cases such as where there is fraud.

lations that differ from those that would be made between independent enterprises, then any profits that would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly;⁷¹¹ and

(ii) Second, where an enterprise of a Contracting State carries on business in another Contracting State through a PE situated therein, there must be attributed to that PE the profits that it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a PE.⁷¹²

The Arbitration Convention is silent, however, as to how it should be applied in triangular cases or cases where more than two enterprises are involved. The above “principles” would seem to suggest that the Convention be applied bilaterally, rather than multilaterally (a transfer pricing dispute between various Member States thus being treated as a series of separate bilateral cases).⁷¹³

On the proposed codification of the arm’s length standard.

4. *Methods of Eliminating Double Taxation*

For the purposes of the Arbitration Convention, the double taxation of profits is regarded as eliminated if either:

- (i) The profits are included in the computation of taxable profits in one State only (method of elimination of double taxation at the level of the tax base); or
- (ii) The tax chargeable on those profits in one State is reduced by an amount equal to the tax chargeable on them in the other jurisdiction (method of elimination of double taxation at the level of the tax amount).⁷¹⁴

5. *Procedural Aspects*

a. *Unilateral Relief or “Amicable” Procedure*

A Contracting State intending to adjust the profits of an enterprise in accordance with the arm’s length principle set out in the Convention must inform the enterprise of the intended action in due time and give it the opportunity to inform the other enterprise concerned to give that other enterprise the opportunity to inform the other Contracting State concerned.⁷¹⁵

If, after such information has been provided, the two enterprises and the other Contracting State agree to the adjustment, this means that:

- (i) The primary adjustment made by the first Contracting State has been unilaterally approved by the second Contracting State; and

- (ii) The second Contracting State undertakes to make a corresponding adjustment, relieving the enterprises of any double taxation that would otherwise arise.⁷¹⁶

The Contracting State providing the information is not prevented from making the proposed adjustment and from assessing and collecting the additional taxes due either before or during the unilateral relief procedure (unless its domestic laws allow for a stay of the assessment proceedings or, at least, a stay of the enforcement of an assessment).

b. *Mutual Agreement Procedure*

The Arbitration Convention provides for a multi-step procedure.

First, the taxpayer is to present its case and the tax assessment subject to challenge to the competent authority of the Member State in which the taxpayer is located.⁷¹⁷ That Member State must notify the authorities of the other Member State(s) concerned. The Convention does not specify in what form a taxpayer is to present its claim, or what documents and arguments are to be included. Nonetheless, the taxpayer’s application should indicate the reasons for the complaint, which should be based on the fact that the transfer pricing principles set out in the Convention have not been observed.

Provided the complaint is well-founded, the competent authorities must endeavor to resolve the case within two years by mutual agreement with the competent authorities of any other States concerned.⁷¹⁸ This two-year period starts from the date on which the case is first submitted to one of the competent authorities, except that, if the case has been submitted to a domestic court, the two-year period will be computed as from the date on which the judgment of the final court of appeal is rendered.⁷¹⁹ This exception would, in many cases, require the taxpayer to make a choice between a domestic judicial procedure and the MAP provided for by the Arbitration Convention. This will either be because a combination of both these procedures is not possible or because the delay in obtaining a binding decision under the Arbitration Convention would then be too long (since a MAP may last as long as two years beyond the domestic procedure, which might very well prove a discouragement to many in the business community).

If the fiscal authorities concerned fail to reach an agreement that eliminates double taxation within two years of the case first being presented to them, they must transfer the case to an advisory commission and agree from the outset to accept

⁷¹¹ Arbitration Convention, Art. 4(1). According to the Commission, Art. 4(1) is sufficiently broad to cover all aspects of thin capitalization rules, whether they concern the interest rate or the amount of the loan, as these aspects ultimately all affect the profits of the associated enterprises.

⁷¹² Arbitration Convention, Art. 4(2).

⁷¹³ The 2009 Revised Code of Conduct sheds more light on this issue (see XII.B.6., below).

⁷¹⁴ Arbitration Convention, Art. 14.

⁷¹⁵ Arbitration Convention, Art. 5.

⁷¹⁶ By way of a general remark, it is regrettable that the Arbitration Convention does not contain any specifications as to the principles underlying, and the conditions for making, correlative adjustments.

⁷¹⁷ According to the EU Joint Transfer Pricing Forum (JTPF) (see XII.B.6., below), all Member States consider that the starting point should be the date of the first tax assessment notice that results, or is likely to result, in double taxation.

⁷¹⁸ Arbitration Convention, Arts. 6(2) and 7(1). The competent authorities may, however, deviate from the two-year limit by mutual agreement and with the agreement of the taxpayer in question.

⁷¹⁹ Arbitration Convention, Art. 7(1).

the latter's decision as binding.⁷²⁰ This is the starting point of the actual "arbitration" phase.

The advisory commission is to consist of two representatives from each country concerned (the number can be reduced to one by mutual agreement of the authorities) and an even number of independent persons appointed by mutual agreement from a list of independent persons of standing. The chairman of the advisory commission is to be appointed from among those independent persons of standing.⁷²¹

For the purposes of this procedure, the associated enterprises concerned may provide any information, evidence or documents that seem to them likely to be of use to the advisory commission in reaching a decision. In addition, the enterprises and the competent authorities of the Contracting States concerned are to respond to any request made by the advisory commission to provide information, evidence or documents. However, the competent authorities of any such Contracting State are not under any obligation to:

- (i) Undertake administrative measures at variance with that State's domestic law or its normal administrative practice;
- (ii) Supply information that is not obtainable under the State's domestic law or in its normal administrative practice; or
- (iii) Supply information that would disclose any trade, business, industrial or professional secret or trade process, or information the disclosure of which would be contrary to public policy.⁷²²

The advisory commission must render its decision on a case, by a majority vote, within six months.⁷²³ There is then an additional opportunity for consultation between the relevant Member States' tax authorities and a different result to be reached within six months thereafter, provided any such different result still avoids double taxation.⁷²⁴ This is the only exception to the otherwise binding nature of the advisory commission's findings.

Given the various time periods involved, the overall delay in achieving final resolution of such a tax dispute can be as long as three years. In addition, it is worth repeating that the Contracting States can avoid the procedure if one of the enterprises concerned is held liable to a "serious penalty" under the relevant domestic law.⁷²⁵

⁷²⁰ There is one exception to the obligation to set up an advisory commission. Specifically, where the domestic law of a Member State does not allow the competent authorities of that State to derogate from the decisions of the judicial system, the relevant competent authorities are only obligated to appoint an advisory commission if the time provided for appeal has expired or if the enterprise has withdrawn such an appeal before a decision was rendered. See Arbitration Convention, Art. 7(3).

⁷²¹ There are detailed rules in the Convention as to how these various appointments and lists of independent persons are to be devised and used in practice. Arbitration Convention, Art. 9.

⁷²² Arbitration Convention, Art. 10(1).

⁷²³ Arbitration Convention, Art. 11(1).

⁷²⁴ Arbitration Convention, Art. 12(1).

⁷²⁵ Arbitration Convention, Art. 8(1).

6. Codes of Conduct

The EU Joint Transfer Pricing Forum (JTPF), an expert group assisting and advising the Commission on transfer pricing matters, was set up by the Commission in October 2002, following a Commission Communication issued in 2001.⁷²⁶ The JTPF's mandate was to:

- (i) Find pragmatic solutions to problems arising from the application of the arm's-length principle; and
- (ii) Ensure the elimination of any double taxation that may arise.⁷²⁷

The JTPF consisted of representatives of the Member States as well as non-government members.

The Commission reported on the work of the JTPF on four occasions in four Communications:

- (i) The first Communication⁷²⁸ presented a Code of Conduct for the Arbitration Convention that sought to ensure that the Arbitration Convention would operate more efficiently (the "2006 Code of Conduct").

- (ii) The second Communication⁷²⁹ presented a Code of Conduct concerning documentation requirements for transfer pricing within the European Union (the "EU Transfer Pricing Documentation (EU TPD) Code of Conduct"). The EU TPD Code of Conduct sought to ensure a consistent approach by setting out the type of documentation that Member States should request and accept for the purposes of their own transfer pricing rules.

- (iii) The third Communication presented guidelines for Advance Pricing Agreements (APAs) within the European Union.⁷³⁰

- (iv) The fourth Communication⁷³¹ reports on the work of the JTPF in the period from March 2007 to March 2009 and presents in an annex a revised Code of Conduct for the Arbitration Convention (the "2009 Revised Code of Conduct").

⁷²⁶ Communication of Oct. 23, 2001 from the Commission to the Council, the European Parliament and the Economic and Social Committee: Towards an internal market without obstacles — A strategy for providing companies with a consolidated corporate tax base for their EU-wide activities, COM (2001) 582 final.

⁷²⁷ See, e.g., EU JTPF, Revised Discussion Paper on the improvement of the functioning of the Arbitration Convention, EU JTPF, DOC: JTPF/011/REV1/2013/EN and EU JTPF, Revised Draft Report on Improving the Functioning of the Arbitration Convention, Brussels, Meeting of October 24, 2014, Taxud/D1, DOC: JTPF/004/REV1/2014/EN (see below).

⁷²⁸ Communication of April 23, 2004 from the Commission to the Council, the European Parliament and the European Economic and Social Committee on the work of the EU Joint Transfer Pricing Forum in the field of business taxation from October 2002 to December 2003 and on a proposal for a Code of Conduct for the effective implementation of the Arbitration Convention, COM (2004) 297 final.

⁷²⁹ COM (2005) 543 final.

⁷³⁰ APAs are seen as an efficient tool for dispute avoidance in that they provide advance certainty concerning transfer pricing methodology.

⁷³¹ Communication of September 14, 2009 from the Commission to the Council, the European Parliament and the European Economic and Social Committee on the work of the EU Joint Transfer Pricing Forum in the period March 2007 to March 2009 and a related proposal for a revised Code of Conduct for the effective implementation of the Arbitration Convention, COM (2009) 472 final.

The objective of the 2006 Code of Conduct was to:

- (i) Ensure that all Member States apply the Arbitration Convention more effectively and in a uniform manner; and
- (ii) Establish procedures to enable smooth and timely progress through the various stages of the Arbitration Convention.

The key features of the 2006 Code of Conduct are:

- (i) A definition of the starting point for the three-year deadline for presenting a case before the competent authorities under the Arbitration Convention;
- (ii) A definition of the starting point for the two-year deadline for the competent authorities to reach a mutual agreement;
- (iii) A description of the practical functioning of the MAP; and
- (iv) A description of the proceedings during the second phase of the procedure, i.e., the advisory commission procedure.

The 2006 Code of Conduct also contained a recommendation to the Member States on the suspension of tax collection while cross-border dispute resolution procedures are in progress.

Based on the practical experience gained since this first Code of Conduct, the JTPF members were of the opinion that it would be useful to seek a common view of the interpretation of some provisions of the Code. The topics specifically identified were:

- (i) Serious penalties;
- (ii) The scope of the Arbitration Convention (triangular transfer pricing and thin capitalization cases);
- (iii) Interest charged/credited by a tax administration when a case is dealt with under the Arbitration Convention;
- (iv) The functioning of the Arbitration Convention (rules on the deadline for setting up the advisory commission and criteria for establishing the independence of independent persons of standing);
- (v) The date from which a case is admissible under the Arbitration Convention; and
- (vi) The interaction between the Arbitration Convention and domestic litigation.

It was against this background that the 2009 Revised Code of Conduct was issued. The 2009 Revised Code of Conduct confirms that triangular transfer pricing cases fall within the scope of the Arbitration Convention. A triangular case is a case in which two Member States involved in a MAP cannot fully resolve any double taxation arising in a transfer pricing case when applying the arm's-length principle because an associated enterprise — as defined in the Arbitration Convention — situated in a third Member State and identified by both EU competent authorities (the evidence being based on a comparability analysis including a functional analysis and other related factual elements) had a significant influence in contributing to a non-arm's-length result in a chain of relevant transactions or commercial/financial relations, and is recognized as having had

such an influence by the taxpayer suffering the double taxation and requesting the MAP.

As regards thin capitalization cases, the 2009 Revised Code of Conduct confirms that profit adjustments arising from financial relations, including loans and their terms, and based on the arm's-length principle, are to be considered within the scope of the Arbitration Convention.

As regards the concept of a “serious penalty” and, more specifically, flexibility in refusing to give access to the Arbitration Convention as a result of the imposition of a serious penalty, the 2009 Revised Code of Conduct recommends that Member States clarify or revise their unilateral declarations in the Annex to the Arbitration Convention to better reflect the position that a serious penalty should be applied only in exceptional cases (for example, where fraud is present).

Finally, the 2009 Revised Code of Conduct provides further detail regarding other matters, including:

- (i) The starting point for the three-year period (deadline for submitting the claim);
- (ii) The starting point for the two-year period (i.e., the period during which Member States are to endeavor to resolve a case);
- (iii) The tax collection and interest charges during cross-border dispute resolution procedures; and
- (iv) The overall practical functioning and transparency of the system.

It should be borne in mind that, as such, the Codes of Conduct do not have binding effect but rather have the status of soft law expressing the level of political commitment achieved among Member States to date in the transfer pricing area and the (related) elimination of double taxation in connection with the adjustment of profits of associated enterprises.

The EU JTPF's mandate expired in March 2019 and was not renewed. However, a possible relaunch of the JTPF would seem to be under consideration in the context of the Transfer Pricing Proposal.

7. Comment

It is generally recognized that the Arbitration Convention has the potential to evolve into an important tool for tackling double taxation in an EU context. It is also felt, however, that the current procedures have their deficiencies, which may possibly explain the relatively low number of cases that have actually been submitted to date.⁷³²

The Transfer Pricing Proposal, if and when adopted, may possibly create renewed momentum for the Arbitration Convention as the Commission considers the Convention to be “complementary” to the Proposal.

⁷³² Statistical data are collected and published by the Commission on an annual basis. See for the latest publication on December 11, 2023: https://taxation-customs.ec.europa.eu/system/files/2023-12/AC%20MAP_2022_Final.pdf. Future MAP statistics will be collected as part of the statistical data on disputes under the Double Taxation Dispute Resolution Mechanisms Directive discussed at XII.C., below.

C. Double Taxation Dispute Resolution Mechanisms Directive

1. Overview and Discussion

While the Arbitration Convention works well in many cases, intensive monitoring since its entry into force has revealed that there are also substantial shortcomings regarding taxpayer access to the Arbitration Convention mechanisms, coverage, timeliness and conclusiveness. Moreover, in the Commission's view, the traditional methods of resolving disputes are no longer fully adapted to the complexities and risks of the current global tax environment.

For these reasons, on October 25, 2016, the Commission tabled a Proposal for a Council Directive on Double Taxation Dispute Resolution Mechanisms in the European Union (the "Dispute Resolution Proposal").⁷³³ It was adopted by the Council on October 10, 2017 as the Dispute Resolution Mechanisms Directive (the "DRM Directive").⁷³⁴

The DRM Directive builds on the Arbitration Convention but broadens its scope to areas that it currently does not cover and adds targeted features to address the main shortcomings

⁷³³ COM (2016) 686 final, 2016/0338 (CNS); see also {SWD (2016) 343 final} and {SWD (2016) 344 final}. According to the Commission, the Dispute Resolution Proposal complements the proposal on the common consolidated corporate tax base (CCCTB). Since consolidation is only part of the second phase of the new approach to CCCTB, there would still be a need for effective dispute resolution mechanisms. Moreover, although a fully adopted CCCTB is designed to ensure that profits are taxed where they are generated, not all companies will be within the mandatory scope of the CCCTB. It can therefore be expected that double taxation disputes will continue to arise, for which appropriate mechanisms need to be in place. As regards the (C)CCTB, see X., above.

⁷³⁴ Council Directive (EU) 2017/1852 of Oct. 10, 2017 on tax dispute resolution mechanisms in the European Union.

identified (for example, by enhancing the enforceability and effectiveness of the mechanism). The DRM Directive does not replace the Arbitration Convention but exists "in addition" to it.

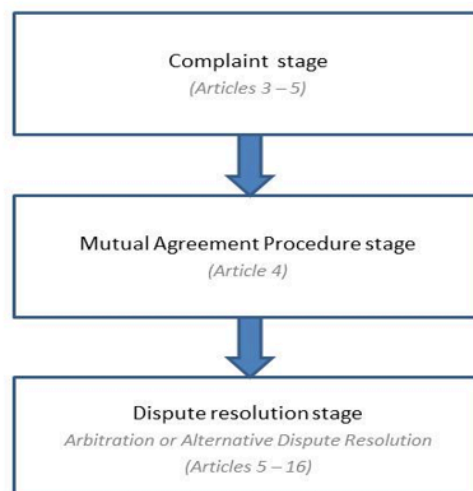
The DRM Directive applies to all cross-border situations subject to double income tax, not just to transfer pricing and PE situations. Specifically, it sets out a mechanism for resolving disputes between Member States that arise from the interpretation and application of agreements and conventions providing for the elimination of the double taxation of income and, where applicable, capital. The objective of eliminating double taxation and the specific situations this should cover are restated in the same terms as those in the Arbitration Convention. The DRM Directive, however, adds an explicit obligation of on the Member States to achieve a result, as well as a clearly defined time-limit. Situations that represent double non-taxation or cases of fraud, willful default or gross negligence are expressly excluded.

In line with the Arbitration Convention, the DRM Directive provides for a MAP, initiated by the complaint of a taxpayer, allowing the Member States to cooperate freely and reach an agreement on the double taxation dispute within two years. Failure of the MAP automatically leads to the initiation of a dispute resolution procedure resulting in the issuance of a final mandatory binding decision by the competent authorities of the Member States involved.

The three key procedural stages are:

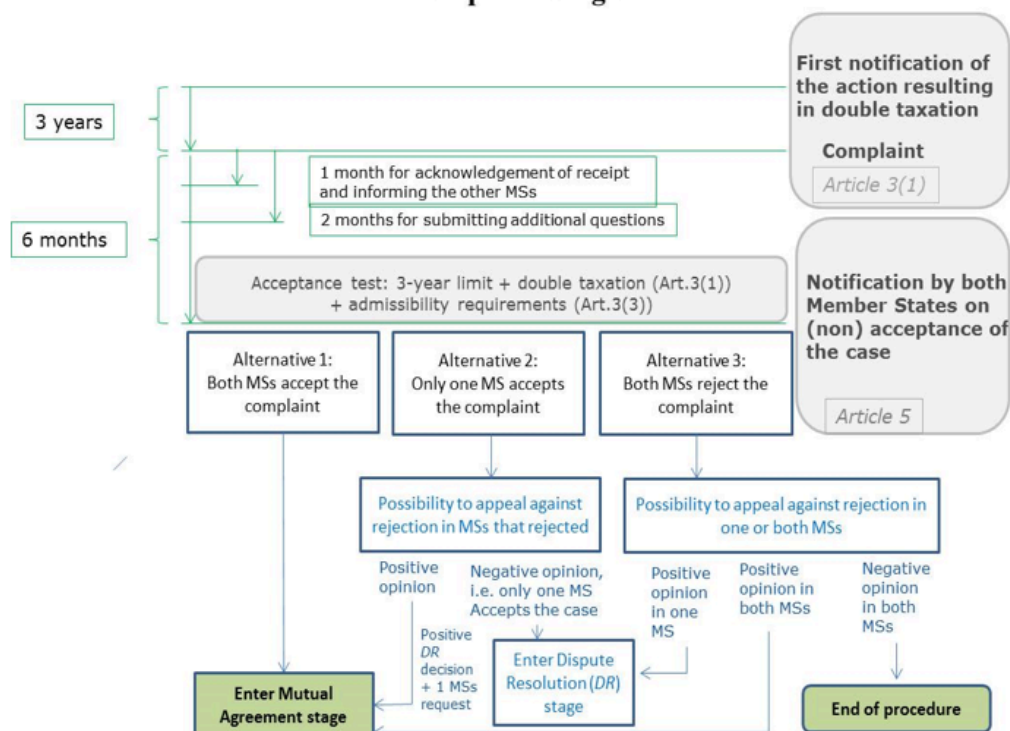
- (i) The complaint;
- (ii) The MAP; and
- (iii) The dispute resolution procedure.

EU Double Taxation Dispute Resolution Mechanism – procedural stages



The different steps followed at the complaint stage are:

Complaint Stage



(i) A taxpayer that is subject to double taxation has three years from the receipt of the first notification giving rise to the double taxation within which to notify the relevant competent authorities in the appropriate Member States involved.

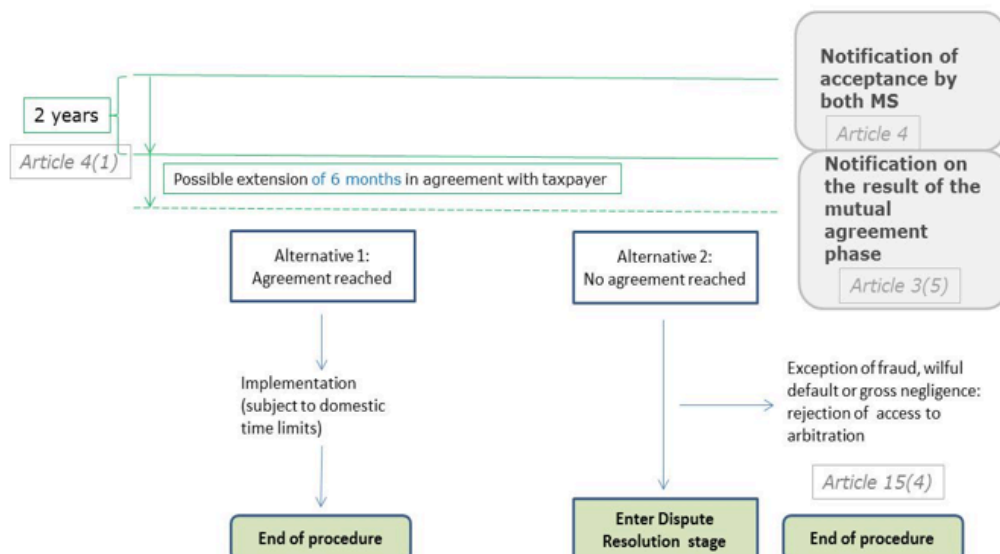
(ii) Certain information prescribed by Article 3 of the Directive must be included in the complaint. The competent authority is empowered to request further information within two months of receiving the complaint.

(iii) The competent authorities have one month within which to notify the taxpayer of their acknowledgement of receipt of the complaint.

(iv) The competent authorities must inform the taxpayer of their decision on the admissibility of the complaint within six months of receiving it.

The connection between the complaint stage and the MAP stage is as follows:

The EU Double Taxation Dispute Resolution Mechanism – Mutual Agreement Procedure Stage



(i) If they accept the complaint, the competent authorities have two years to resolve the double taxation by means of the MAP.

(ii) The two-year period can be extended by six months if appropriate justification is provided in writing by one of the competent authorities.

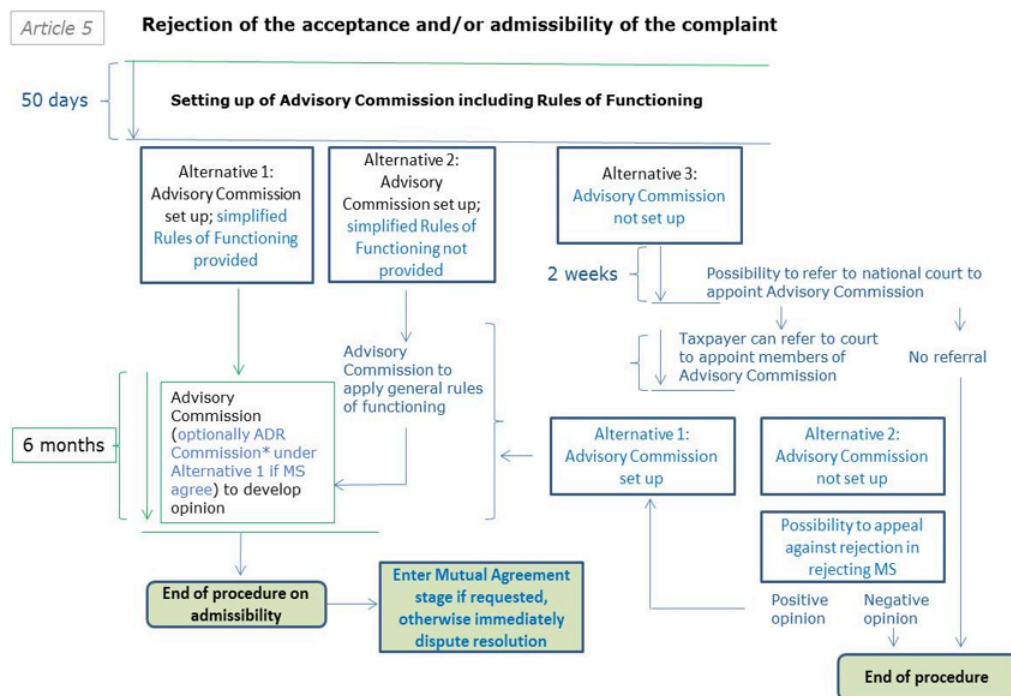
(iii) Once the dispute is resolved, the taxpayer must be notified and the decision will be binding on the competent authorities and enforceable by the taxpayer, provided the taxpayer renounces any rights under domestic law.

(iv) Implementation of the MAP is not to be subject to any national time limits prescribed in domestic legislation.

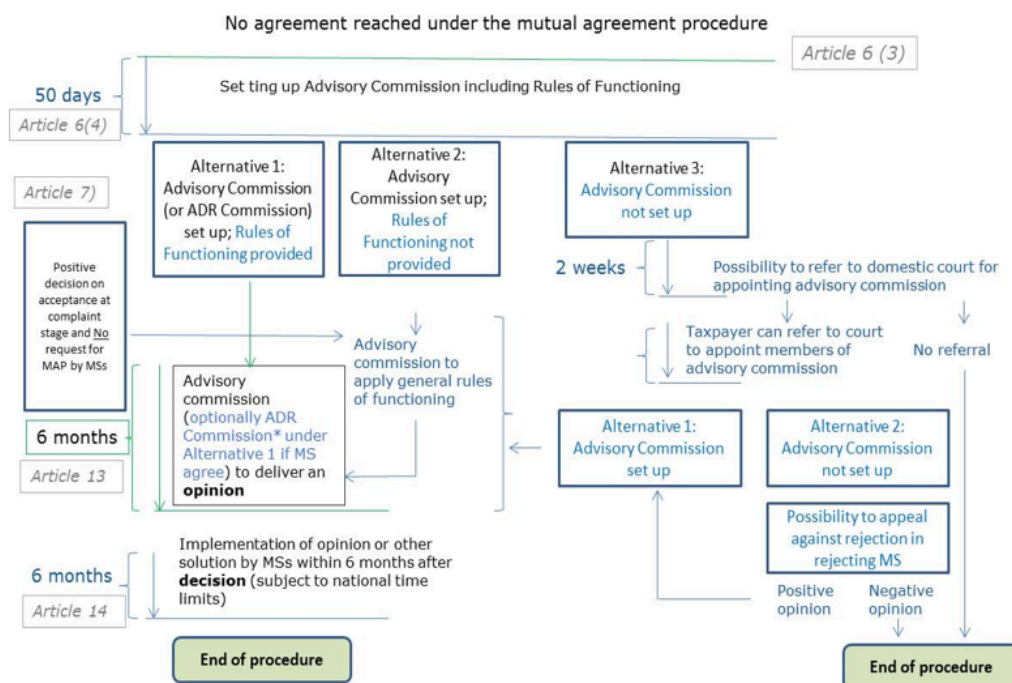
(v) A complaint can only be rejected for specifically defined reasons, i.e., if it is inadmissible, if no double taxation exists or if the complaint is made outside the prescribed three-year period.

The dispute resolution stage is illustrated by the following two diagrams:

Dispute Resolution Stage (Decision on acceptance and admissibility)



Dispute Resolution Stage (Elimination of double taxation)



(i) The initial MAP phase is supplemented by an automatic arbitration procedure that envisages settlement of a dispute by way of arbitration within a timeline of 15 months if the Member States involved fail to reach an agreement during the initial amicable phase. (Situations in which neither Member State agrees on the admissibility of a taxpayer's case to the MAP phase can also be submitted to arbitration at an earlier stage to resolve the conflict regarding the admissibility of the case (potential denial of access), provided the taxpayer requests this and establishes that it has renounced domestic remedies or that the recourse period for such remedies has expired.)

(ii) An "Advisory Commission" consisting of three to five independent persons (arbitrators) must be appointed (one or two for each Member State involved plus one independent chairman), together with two representatives of each Member State.

(iii) The "Advisory Commission" issues a final opinion on the elimination of double taxation in the disputed case that is binding on the Member States involved, unless they agree on an alternative solution for eliminating the double taxation (i.e., as an alternative to setting up an Advisory Commission, the Member States may instead opt to establish an Alternative Dispute Resolution Commission).

(iv) A default fast-track enforcement mechanism supervised by the competent national courts of each Member State involved is created in cases in which the Advisory Commission is not set up within a certain time limit. In such cases, the taxpayer may ask the national court to appoint the independent persons who then choose the chairman. The independent persons and the chairman are to be selected from a pre-set list maintained by the European Commission.

(v) A framework for the functioning of the Advisory Commission (the "Rules of Functioning") is provided. These rules cover substantial aspects, such as the description of a case, the definition of the underlying legal basis and the questions to be addressed by the Advisory Commission, and some key logistical and organizational aspects, such as the timeline, the organization of meetings and hearings, the exchange of documents, the working language and cost administration.

(vi) The terms and conditions, including the compulsory timeline, under which the Advisory Commission must issue its opinion, which forms the reference point for the subsequent final and binding decision of the competent authorities, follow the relevant provisions of the Arbitration Convention. The same holds true for the interaction of the procedure with domestic judicial proceedings and appeals, and the publication of the final arbitration decision and more detailed information (subject to the agreement of the taxpayer concerned).

The DRM Directive applies to any complaint submitted on or after July 1, 2019 concerning a dispute relating to income or (where applicable) capital earned in a tax year commencing on or after January 1, 2018. However, the competent authorities of the Member States may agree to apply the Directive with regard to any complaint submitted prior to that date or with respect to earlier tax years.

2. Evaluation

In the OECD's opinion, the DRM Directive theoretically makes multilateral mutual agreement procedures possible, even

though the procedural rules contained in the directive are not tailored to suit such procedures.⁷³⁵

On March 12, 2024, the EU Commission launched a public consultation aimed at gathering input from stakeholders regarding the DRM, with the objective of evaluating the DRM's functioning during its initial years of implementation.⁷³⁶ The deadline for submissions to the consultation was May 10, 2024.

In the context of the public consultation, the KPMG Tax Controversy network, in cooperation with KPMG's EU Tax Centre, conducted an internal survey across the network of KPMG firms based in Europe with a view to collecting key insights into the functioning of the DRM and thus providing input to the Commission. The survey findings identified the following shortcomings within the DRM:

- (i) A significant percentage of Member States (38%) opt to suspend arbitration when taxpayers face penalties, particularly in cases of tax fraud, willful default or gross negligence;
- (ii) 26% of Member States refuse arbitration committee access when disputes involve qualification issues rather than double taxation matters (such disputes may not always result in double taxation, but they could lead to tax being erroneously imposed); and
- (iii) A substantial concern relates to interest accruing on taxes due, i.e., despite the potential for interest to accumulate during prolonged proceedings, the DRM lacks provisions for automatic offsetting in dispute resolutions, potentially resulting in a double payment of interest that can have considerable financial implications.

In its Opinion Statement FC 2/2024 of May 10, 2024 Responding to the EU Commission Consultation on Dispute Res-

⁷³⁵ See, OECD (2023), *Manual on the Handling of Multilateral Mutual Agreement Procedures and Advance Pricing Arrangements*, OECD Forum on Tax Administration, OECD, Paris, <https://doi.org/10.1787/f0cad7f3-en>, p.12, para 4.

⁷³⁶ https://taxation-customs.ec.europa.eu/news/commission-launches-targeted-consultation-get-feedback-rules-governing-tax-dispute-resolution-eu-2024-03-13_en.

olution Mechanisms in the European Union,⁷³⁷ CFE Tax Advisers Europe raised the following points:

- (i) Closer involvement of the taxpayer in the process would increase tax certainty and the trust of taxpayers in these types of dispute resolution procedures.
- (ii) Relationships between taxpayers and tax administrations would be improved if transparency were reciprocal. Improving tax transparency of tax administrations towards taxpayers would enhance the trust of taxpayers and legal certainty.
- (iii) Member States and tax administrations should be required to provide guidelines to taxpayers on the implementation and application of the DRM.
- (iv) It would also be crucial to remove barriers to the availability of certain remedies, such as tax administrations imposing criminal penalties or pushing for settlements by offering better bargaining positions with a view to closing the door to the MAP.
- (v) It would be important to ensure that the DRM is an appropriate tool for dealing with future disputes related to the application of the Pillar Two rules as implemented in the European Union through the Pillar Two Directive.
- (vi) The number of disputes may increase in the European Union should the Transfer Pricing Proposal be adopted, given that the Proposal sets the threshold for control at a 25% shareholding level, while the OECD Transfer Pricing Guidelines apply a 50% shareholding threshold to determine whether the control criterion is satisfied. The 25% threshold would dramatically increase the transfer pricing compliance burden on companies operating in the European Union and as a consequence broaden the scope of transactions potentially subject to dispute between (two) EU Member State tax administrations.

⁷³⁷ https://taxadviserseurope.org/new_ahagency/wp-content/uploads/2024/05/CFE-Opinion-Statement-on-the-EU-Dispute-Resolution-Directive.pdf.

XIII. European Corporate Vehicles

A. European Economic Interest Grouping

Executive Summary

This Section discusses the legal framework and tax treatment of corporate vehicles that can be established at EU level, i.e., European Economic Interest Groupings (see XIII.A., below) and European Companies, European Cooperative Societies, European Private Companies, and the EU Inc. (see XIII.B., below).

On July 25, 1985, the Council adopted Council Regulation 2137/85/EEC on the European Economic Interest Grouping (EEIG), which was largely inspired by the economic interest grouping (*groupement d'intérêt économique*) introduced in French law in 1967.

An EEIG may be defined as a legal vehicle for the cooperation of two or more enterprises situated in at least two different Member States that may continue for an unlimited period of time. The aim of an EEIG is to facilitate or develop the economic activities of its members and to enhance the results of such activities.

From a tax perspective, Article 40 of the EEIG Regulation provides that the profits or losses resulting from the activities of an EEIG are taxable only in the hands of its members. This means that EEIGs are transparent for income tax purposes. The inclusion of only one (brief) tax provision leaves many questions as to the precise tax regime governing such entities unanswered.

For example, from a US perspective, one of the key questions is whether an EEIG would qualify as a partnership or as a corporation for US tax purposes. On balance, it would appear to qualify as a partnership.

Recital 14 of the EEIG Regulation specifies that national tax laws apply, particularly as regards the apportionment of profits, tax procedures and any obligations imposed by such laws. However, the specific tax rules in each Member State are not wholly harmonized, particularly as regards whether an EEIG established in any one Member State will be treated as creating a PE in that State for each of its (nonresident) members.

Under the OECD Model Convention (which is closely followed by most European tax treaties), mere membership in a tax transparent entity is not automatically deemed to give rise to the existence of a PE. A PE will be deemed to exist in the Member State in which an EEIG is located if, by way of its membership of the EEIG, a nonresident member takes part in business activities that involve the presence of a fixed place of business in that Member State. However, no PE will be deemed to exist if the activities of the fixed place of business are confined to auxiliary and preparatory services rendered for the undertaking on which the establishment is dependent (the "PE exception").

The PE exception is particularly relevant in the context of an EEIG. Under the EEIG Regulation, an EEIG is allowed to carry on only activities ancillary to the activities carried on by its members, which, most likely, will be of a preparatory and

auxiliary nature with respect to the activities of the members. It has been argued that the PE exception can never apply to an EEIG — since an EEIG, by definition, has more than one member, the condition that services are to be rendered only for the undertaking on which the establishment is dependent cannot be fulfilled. However, it would appear that the PE exception should not be precluded in cases where an EEIG only renders services to its own members, even though the EEIG has more than one member. A logical interpretation would seem to require that the PE exception should only be precluded where an EEIG renders services to a third party that is not a member of the EEIG. Nonetheless, the potentially different treatment of EEIG members, depending on their countries of residence, seems likely to be resolved only following case-by-case negotiations and rulings, at least for the time being.

It may perhaps be for this reason that many of the EEIGs established to date have tended to represent groups of lawyers, tax advisors and other service providers engaged primarily in joint marketing activities, where there is a relatively low risk of a PE being found to exist in one jurisdiction or another. Many of the other EEIGs tend to be groupings formed for other auxiliary activities, such as promotional or lobbying efforts. Relatively few EEIGs have been proposed for more substantial efforts, such as R&D cost sharing, where an eventual risk of creating a taxable PE is more likely to arise.

B. European Company, European Cooperative Society, European Private Company

1. European Company

More than 30 years after the first proposal, Council Regulation No. 2157/2001⁷³⁸ provided the legal basis for the establishment of a European public limited-liability company (a *Societas Europaea*, SE or European company) under EU law.⁷³⁹ Taking into account the three-year delay in the transposition of the Directive into national laws, the legislation came into effect on October 8, 2004.

SEs are intended to:

- (i) Enable the creation and management of companies with a European dimension, free from the obstacles arising from the disparity and the limited territorial application of national company laws.
- (ii) Allow businesses across borders within the European Union to incorporate using a legal entity subject to the same rules in each Member State, thus permitting European enterprises to compete more effectively with their US and Japanese counterparts.
- (iii) Facilitate the cross-border restructuring of companies from different Member States (for example, by enabling companies established in different Member States to merge and operate throughout the European Union based

⁷³⁸ In combination with the related Directive concerning worker involvement in SEs. See Council Directive 2001/86/EC of October 8, 2001, supplementing the Statute for a European Company with regard to the involvement of employees.

⁷³⁹ Council Regulation No. 2157/2001 of October 8, 2001 on the Statute for a European Company.

on a single set of rules and a unified management and reporting system).

(iv) Significantly reduce administrative and legal costs as a result of a single structure and unified management.

An SE can be created via a merger of two or more companies from at least two different Member States. It may also be set up through:

- (i) The formation of a holding company by two or more companies of different Member States;
- (ii) The formation of a subsidiary of companies of at least two different Member States; or
- (iii) The transformation of a public limited company of one Member State that has had a subsidiary in another Member State for at least two years.

The minimum capital of an SE to be issued and subscribed for is 120,000 euros. However, where a Member State requires a higher amount of capital for a company carrying on certain types of activities (for example, financial activities), the same requirement will also apply to an SE with its registered office in that Member State.

The registered office of an SE, as designated in its articles of association, must be the place where it has its central administration, i.e., its true center of operations. An SE acquires the status of an independent legal entity only on registration, which will be disclosed for information purposes in the Official Journal of the European Communities. An SE may move its registered office within the European Union. Such a transfer to another Member State does not result in the winding up of the SE or the creation of a new legal person.

The articles of association of an SE must provide for a general meeting of shareholders and either a management board and a supervisory board (two-tier board) or an administrative board (one-tier board). Under the two-tier board system, an SE is managed by a management board. The member or members of the management board has/have the power to represent the SE externally and in legal proceedings. They are appointed and removed by the supervisory board. No person may be a member of both the management board and the supervisory board of an SE at the same time, but the supervisory board may appoint one of its members to exercise the functions of a member of the management board in the event of the absence of management board members (for instance, during holidays). During such a period, the functions of the person concerned as a member of the supervisory board are suspended.

Under the one-tier board system, an SE is managed by an “administrative” board. The member or members of the administrative board has/have the power to represent the company in dealings with third parties and in legal proceedings. Under the one-tier board system, the administrative board may delegate the power of management to one or more of its members.

Winding-up, liquidation, insolvency and the suspension of payments are largely governed by national law. If an SE transfers its registered office outside the European Union, or no longer complies with requirements of Article 7 of the Statute in any other manner, the Member State concerned must take appropriate measures to ensure compliance or the liquidation of the SE.

2. European Cooperative Society

Council Regulation No. 1435/2003 introduced the Statute for a European Cooperative Society (*Societas Cooperativa Europaea* or SCE).⁷⁴⁰ Its objective is to provide cooperatives with adequate legal instruments to facilitate their cross-border and transnational activities. The Statute for a European Cooperative Society mirrors the Statute for a European Company adopted in 2001 (see above) but has been tailored to the specific characteristics of cooperative societies. The Statute is not only of interest to cooperatives, however. It also provides an ideal legal instrument for companies of all types wishing to group together for their common benefit, for example, to access markets, achieve economies of scale or undertake R&D activities.

The Statute also enables five or more European citizens (physical persons) from more than one Member State to create an SCE. An SCE (like all cooperatives) is a legal entity that allows its members (whether physical persons or legal entities) to carry on certain activities in common, while preserving their independence. The members of an SCE will normally be customers or suppliers and will be directly and personally involved in the activities and management of the SCE. An SCE must have as its principal object the satisfaction of its members’ needs and/or the development of their economic and social activities, and not the remuneration of a capital investment. The members benefit proportionally to the volume of their trade with the cooperative (and not their capital contributions).

The SCE is an optional legal form and does not replace existing laws governing cooperatives at national or regional levels. As it is an instrument designed to facilitate transnational co-operation, its members must be resident in more than one Member State. An SCE may be created:

- (i) *Ex novo*, by five or more natural persons, by two or more legal entities or by a combination of five or more natural persons and legal entities;
- (ii) By a merger of two or more existing cooperatives; or
- (iii) By the conversion of an existing cooperative of one Member State that has, for at least two years, had an establishment or subsidiary in another Member State.

In the first two cases, at least two of the natural persons or legal entities concerned must be from different Member States. The minimum required capital is 30,000 euros. An SCE has a variable share capital and may have among its members not only customers or suppliers but, in some circumstances, a limited proportion of “investor members” that do not use the services of the cooperative. The voting rights of investor members are limited. An SCE must be registered in the Member State in which it has its head office but may move its registered office from one Member State to another without having to wind-up and re-register.

⁷⁴⁰ Council Regulation No. 14235/2003 of July 22, 2003 on the Statute for a European Cooperative Society (SCE), which was adopted in conjunction with Council Directive 2003/72/EC of July 22, 2003, supplementing the Statute for a European Cooperative Society with regard to the involvement of employees.

3. Tax Treatment of European Companies and European Cooperative Societies

Neither the SE Regulation⁷⁴¹ nor the SCE Regulation deals with the tax treatment of, respectively, an SE or an SCE. Instead, this is referred to the national laws of the Member States. Under Article 9(1)(c)(ii) of the SE Regulation, an SE is governed, in matters not regulated by the Regulation or, where matters are only partly so regulated, in relation to those aspects not covered by it, by the provisions of Member States' laws that would apply to a public limited liability company formed in accordance with the law of the Member State in which the SE has its registered office. Similarly, Article 8(1)(c)(ii) of the SCE Regulation states that an SCE is governed, in matters not regulated by the Regulation or, where matters are only partly so regulated, in relation to those aspects not covered by it, by the laws of the Member State that would apply to a cooperative formed in accordance with the law of the Member State in which the SCE has its registered office.

It follows that an SE is treated in accordance with the national fiscal legislation of its state of residence applicable at the company level or the branch level. If the Member State in which the head-office is located taxes the worldwide income of the SE, it will be possible, in the Member State in which the head-office is located, to set the losses of some PEs against the profits of other PEs. The SE will also continue to be a taxpayer in the different Member States in which its PEs are located. Interestingly, the US Internal Revenue Service announced, as long ago as October 2004, that it would treat an SE as a *per se* corporation for US tax ("check-the-box") purposes.

Similarly, an SCE is treated for tax purposes, in the same way as any other multinational company according to the national fiscal legislation applicable at the company or branch level. It will continue to pay taxes in those Member States in which it has PEs.

Both the SE and the SCE fall within the scope of application of the Merger Tax Directive and the Parent-Subsidiary Directive (while their inclusion in the personal scope of the Interest and Royalty Directive is provided for under the 2011 Proposed Interest and Royalty Recast Directive) — see, respectively, III., IV. and V., above).

4. European Private Company

On June 27, 2008, the Commission submitted to the Council a proposal for a Council Regulation on the Statute for a European Private Company (*Societas Privata Europaea* or SPE) (the "SPE Proposal").⁷⁴² The objective of the SPE Proposal was to create a new instrument to enhance the competitiveness of small and medium-sized enterprises (SMEs) by:

- (i) Facilitating their establishment and operation in the Single Market;

- (ii) Providing for a flexible corporate law regime across the European Union; and

- (iii) Reducing the compliance costs that arise on the setting-up and operation of SMEs.

Recital 6 of the SPE Proposal envisages that national law should apply to matters such as tax, as it does in the case of SEs and SCEs. The Proposal was eventually withdrawn in 2014 because no political consensus could be reached on four key issues, i.e.:

- (i) The required cross-border component;
- (ii) The amount of the minimum capital requirement;
- (iii) The possibility of having the registered office and the headquarters in different Member States; and
- (iv) The rules governing worker participation, especially at board level.

5. EU Inc.

On March 18, 2026, the EU Commission presented its proposal for EU Inc., a new single set of corporate rules, building the cornerstone and starting point for the EU's 28th regime, i.e., a regime that is to exist alongside, or as an alternative to, the 27 Member States' national corporate regimes (hence, the reference to a "28th regime").⁷⁴³

Under the Proposal, EU Inc. is construed as an optional, digital-by-default European corporate framework, with — in the words of the EU Commission — as main features:

- **Faster registration:** Entrepreneurs, founders, and companies will be able to found an EU Inc. company within 48 hours, for less than 100 euros and with no minimum share capital requirements.
- **Simpler procedures:** EU Inc. companies will only need to submit their company information once, via an EU-level interface connecting national business registers together. In a second step, the Commission will establish a new central EU register. EU Inc. companies will obtain their tax identification and VAT numbers without having to resubmit paperwork.
- **Fully digital operations:** Corporate processes will be digital by default throughout a company's lifecycle.
- **Helping founders restart faster and cheaper:** EU Inc. companies will have access to fully digital liquidation procedures. Innovative startups will have access to simplified insolvency procedures to facilitate the winding down of operations. This enables founders to try and test innovative ideas and start again if needed.
- **Better conditions to attract investment:** The proposal is intended to remove in-person formalities, provide digital procedures for financing operations, and simplify the transfer of shares (e.g., no more mandatory involvement

⁷⁴¹Originally, only one tax provision was included in the SE proposal (specifically, the August 25, 1989 version (OJ No. 0263 of October 16, 1989, at 41)) would have provided for vertical — upwards — loss consolidation in Art. 133), but this was excised because a number of European organizations (representing major European-based multinationals) expressed concern that an SE could have a tax status more privileged than that of other European companies.

⁷⁴²Proposal for a Council Regulation on the Statute for a European private company, COM (2008) 396/3.

⁷⁴³Proposal of March 18, 2026 for a Regulation of the European Parliament and of the Council on the 28th Regime Corporate Legal Framework — 'EU INC.', COM (2026) 321 final, 2026/0074 (COD), {SEC(2026) 321 final} — {SWD(2026) 321} — {SWD(2026) 322} — {COM(2026) 320} — {C(2026) 1800}.

of intermediaries for share transfers and liquidation procedures). The proposal also allows Member States to give EU Inc. companies access to the stock exchange.

- *Better means to attract talents:* EU Inc. companies will be able to set up EU-wide employee stock option plans. The stock option will only be taxed on the income generated once it is sold, which is particularly relevant for innovative startups.

- *Full access to the Single Market:* EU Inc. companies will be free to choose the Member State in which they incorporate. The proposal includes a blacklist of prohibited practices to ensure that EU Inc. companies are treated the same way as any other national companies.

- *Strong safeguards against abuse:* National employment and social laws are not affected by the proposal. They will apply to EU Inc. the same way they apply to any other business under national company law.

- *Flexibility of shares:* EU Inc. companies will have the flexibility to create different classes of shares with varying economic or voting rights (e.g., to protect the EU Inc. against hostile takeovers).

The Commission calls on the European Parliament and the Council to reach an agreement on the EU Inc. Proposal by the end of 2026.

Comment: EU Inc. is a company law proposal, not a tax harmonization proposal. This means that the tax treatment (cor-

porate tax and VAT) of an EU Inc. will (continue to) depend on where it is incorporated or has its principal/real seat and where it operates — just as it does for Member States' national company structures today. See, however, the draft report of the European Parliament's Committee on Economic and Monetary Affairs (ECON) on the feasibility of a 28th tax regime and its potential to support EU competitiveness, as published on March 19, 2026.⁷⁴⁴ The draft report contemplates an optional EU-wide framework under which participating companies, particularly innovative companies, start-ups and scale-ups, would be subject to a single set of tax rules recognized across Member States, with the aim of reducing fragmentation and compliance costs. To this end, the draft report proposes, *inter alia*, the development of a consolidated corporate tax base, allocated between Member States using a formula based on real economic activity, alongside automatic cross-border loss relief and mechanisms to prevent double taxation.⁷⁴⁵

⁷⁴⁴ 2025/2211(INI), Rapporteur: L'udovít Ódor, PR\1339365EN.docx PE: https://www.europarl.europa.eu/doceo/document/ECON-PR-785418_EN.pdf; see also, F. Debelva, J. Luts, A. M. Vandekerkhove and N. Bammens, *Feasibility of a 28th Tax Regime and Its Potential to Support EU Competitiveness — Study requested by the FISC Subcommittee on Tax Matters*, April 2026, [https://www.europarl.europa.eu/RegData/etudes/STUD/2026/772644/EC-TI_STU\(2026\)772644_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/STUD/2026/772644/EC-TI_STU(2026)772644_EN.pdf).

⁷⁴⁵ The deadline for amendments to the draft report was set for April 17, 2026, with a plenary vote currently expected in July 2026.

XIV. Capital Duty Directive

A. Subject Matter and Scope

Executive Summary

This Section discusses the Capital Duty Directive. The Directive regulates the levying of indirect taxes with respect to contributions of capital to capital companies, restructuring operations involving capital companies, and the issue of certain securities and debentures, as further interpreted and clarified by the case law of the CJEU.

The rationale behind the Directive is, in essence, that harmonization of the legislation on indirect taxes on the raising of capital is believed to significantly improve the functioning of the internal market by eliminating factors liable to distort competition or hinder the free movement of capital.

1. General

Council Directive 2008/7/EC of February 12, 2008, concerning indirect taxes on the raising of capital (the “Capital Duty Directive,”) which repealed Council Directive 69/335/EEC of July 17, 1969, concerning indirect taxes on the raising of capital, regulates the levying of indirect taxes with respect to:

- (i) Contributions of capital to “capital companies;”
- (ii) Restructuring operations involving capital companies; and
- (iii) The issue of certain securities and debentures.⁷⁴⁶

For the purposes of the Capital Duty Directive, a “capital company” is:

- (i) Any company that takes one of the forms listed in Annex I to the Directive;
- (ii) Any company, firm, association or legal person the shares in whose capital or assets can be dealt in on a stock exchange; and
- (iii) Any company, firm, association or legal person operating for profit, whose members have the right to dispose of their shares to third parties without prior authorization and are only responsible for the debts of the company, firm, association or legal person to the extent of their shares (Article 2(1)).⁷⁴⁷

In *Drukarnia Multipress*,⁷⁴⁸ the CJEU concluded that a Polish partnership limited by shares (PLS) was a capital company within the meaning of the Capital Duty Directive, Art. 2(1)(b) and (c), despite the fact that only some of its capital and members were able to fulfill the conditions laid down by that provision. The mere fact that a PLS was not listed in [point 21 of] Annex I [as one of the companies under Polish law that must be regarded as capital companies based on the Capital Duty Di-

rective, Art. 2(1)(a)] did not prevent it from being recognized as a capital company. Rather, according to the Court, there was nothing in the Directive to indicate that the EU legislature intended to exclude from the concept of a “capital company” legal structures of a hybrid nature, such as a PLS, in which only some of the shares in the capital or assets could be dealt in on a stock exchange, or in which only some of the members had the right to dispose of their shares to third parties without prior authorization and were responsible for the company’s debts only to the extent of their shares.

Any company, firm, association or legal person operating for profit (other than those listed in Article 2(1) is (also) deemed to be a capital company (Article 2(2)).⁷⁴⁹ Accordingly, any such entity that does not satisfy the criteria set out in Article 2(1) but operates for profit by pooling capital in a separate set of assets, will be subject to capital duty.⁷⁵⁰ Consequently, a grouping of persons that does not have a legal personality and whose members provide capital for a separate fund with a view to making profits is to be deemed to be a capital company without there being any other requirement. It is for the national legislature, however, to determine whether such a grouping is to be regarded as a capital company for the purposes of charging capital duty.⁷⁵¹

A management company of undertakings for collective investment in transferable securities referring to a body of assets, without legal personality, belonging to the participants under the general regime of community of property, falls within the scope of Article 2(2).⁷⁵² However, Member States may, for the purposes of levying capital duty under the derogatory regime (see XIV.B.3., below), choose not to regard such an entity as a capital company.⁷⁵³

The rationale behind the Capital Duty Directive is that indirect taxes on the raising of capital, namely:

- (i) Capital duty (duty chargeable on contributions of capital to companies and firms);
- (ii) Stamp duty on securities; and
- (iii) Duty on restructuring operations, regardless of whether those operations involve an increase in capital, give rise to:
 - (i) Discrimination;
 - (ii) Double taxation; and
 - (iii) Disparities,

that interfere with the free movement of capital.

Other indirect taxes sharing the characteristics of capital duty and stamp duty on securities also give rise to discrimination, double taxation and disparities.⁷⁵⁴ Consequently, harmonization of the legislation on indirect taxes on the raising of capital would significantly improve the functioning of the in-

⁷⁴⁶ Council Directive 2008/7/EC of February 12, 2008 (“Capital Duty Directive”), Art. 1.

⁷⁴⁷ Capital Duty Directive, Art. 2(1).

⁷⁴⁸ Case C-357/13, *Drukarnia Multipress*.

⁷⁴⁹ Capital Duty Directive, Art. 2(2).

⁷⁵⁰ *see e.g.* Case 112/86, *Amro Aandelen Fonds*; Case C-178/05, *Commission v. Greece*.

⁷⁵¹ Case 112/86, *Amro Aandelen Fonds*.

⁷⁵² Case C-656/21, *IM GESTÃO DE ATIVOS and Others*.

⁷⁵³ Capital Duty Directive, Art. 9.

⁷⁵⁴ Capital Duty Directive, Recital (2).

ternal market by eliminating factors liable to distort competition or hinder the free movement of capital.⁷⁵⁵

Admittedly, since the economic effects of capital duty are detrimental to the regrouping and development of undertakings, the best solution for attaining these objectives would be simply to abolish capital duty.⁷⁵⁶ However, the losses of revenue that would result from the immediate application of such a measure are unacceptable to the Member States that currently impose capital duty. As such, these Member States should be able to continue to subject to capital duty all or parts of the relevant transactions. It should be noted that a Member State must charge a single rate of capital duty.

However, once a Member State has chosen not to levy capital duty on all or part of the transactions within the scope of the Capital Duty Directive, it should not be possible for it to reintroduce such duty.⁷⁵⁷ Moreover, as it is inherent in the internal market concept that a duty on the raising of capital within the internal market by a company or firm should not be charged more than once, if the Member State to which the taxing right is granted does not levy capital duty on some or all transactions covered by the Directive, no other Member State is to exercise a taxing right with respect to those transactions.⁷⁵⁸

Finally, apart from capital duty, indirect taxes should not be levied on the raising of capital. In particular, stamp duty should not be levied on securities, regardless of the origin of the securities and whether they represent a company's own capital or its loan capital.⁷⁵⁹

2. Transactions Covered

As indicated in XIV.A.1., above, the Capital Duty Directive regulates the levying of indirect taxes with respect to:

- (i) Contributions of capital to capital companies;
- (ii) Restructuring operations involving capital companies; and
- (iii) The issue of certain securities and debentures.

In *NN (L)*,⁷⁶⁰ a case concerning the Belgian annual tax on undertakings for collective investment (UCIs) payable on the total, as at December 31 of the previous year, of the net amounts invested in Belgium, the CJEU held that the provisions of the Capital Duty Directive did not preclude the legislation of a Member State from imposing an annual tax on UCIs that made UCIs governed by foreign law marketing units in that Member State subject to that tax.

However, according to the Court, a national provision, by which a Member State imposed a specific penalty, namely the prohibition, ordered by a court, of making future investments of its units in that Member State on UCIs governed by foreign law in the event of non-compliance by the latter with the obligation to file the annual declaration necessary for the recovery of a tax on UCIs or in the event of non-payment of that tax had to

be considered to be incompatible with the freedom to provide services (see II.E.5., above).

a. Contributions of Capital

The term “contributions of capital” covers the following transactions (Article 3):

- (i) The formation of a capital company;
- (ii) The conversion into a capital company of a company, firm, association or legal person that is not a capital company;
- (iii) An increase in the capital of a capital company by way of the contribution of assets of any kind;
- (iv) An increase in the assets of a capital company by way of the contribution of assets of any kind, in consideration not of shares in the capital or assets of the company, but of rights of the same kind as those of members, such as voting rights, a share in the profits or a share in the surplus on liquidation;
- (v) The transfer from a third country to a Member State of the center of effective management of a capital company whose registered office is in that third country;
- (vi) The transfer from a third country to a Member State of the registered office of a capital company whose center of effective management is in that third country;
- (vii) An increase in the capital of a capital company by way of the capitalization of profits or permanent or temporary reserves;
- (viii) An increase in the assets of a capital company through the provision of services by a member that does not entail an increase in the company's capital, but results in a variation in the rights in the company or may increase the value of the company's shares;
- (ix) A loan taken up by a capital company, if the creditor is entitled to a share in the profits of the company; and
- (x) A loan taken up by a capital company with a member or a member's spouse or child, or a loan taken up with a third party that is guaranteed by a member, subject to the condition that such a loan has the same function as an increase in the company's capital.

An “increase in the capital” entails a formal increase in a company's capital by means of either an issue of new shares or an increase in the nominal value of the existing shares kind.⁷⁶¹

Inasmuch as the “assets of the company” are defined as all the property that the members have contributed, together with any increase in its value,⁷⁶² an “increase in the assets” includes, in principle, every kind of increase in the net assets of a capital company.⁷⁶³ Thus, for example, the CJEU has classified the following as an “increase in the assets:”

- (i) A transfer of profits,⁷⁶⁴ and

⁷⁵⁵ Capital Duty Directive, Recital (3); Case C-4/97, *Nonwoven v. Direzione Regionale delle Entrate per la Toscana*.

⁷⁵⁶ Capital Duty Directive, Recitals (4) and (5).

⁷⁵⁷ Capital Duty Directive, Recital (6).

⁷⁵⁸ Capital Duty Directive, Recital (7).

⁷⁵⁹ Capital Duty Directive, Recital (9).

⁷⁶⁰ Case C-48/15, *NN (L)*.

⁷⁶¹ Case 270/81, *Felicitas Rickmers-Linie*; Case C-494/03, *Senior Engineering Investments*).

⁷⁶² Case C-38/88, *Siegen*.

⁷⁶³ Case C-46/04, *Aro Tubi Trafilerie*; Case C-494/03, *Senior Engineering Investments*).

(ii) A waiver of a claim.⁷⁶⁵

In contrast, an absorption of a company's losses by a shareholder, pursuant to a profit and loss transfer agreement concluded before those losses are determined, does not increase the assets of that company and, hence, no capital duty may be charged.⁷⁶⁶ Likewise, the absorption by a member of a company's losses under an undertaking given by the member before the losses were sustained, the sole purpose of which was to cover such losses, does not increase the assets of the company.⁷⁶⁷

On the other hand, an interest-free loan may constitute a contribution of capital since it allows the borrowing company to have capital available without having to bear its cost. The resultant saving in interest leads to an increase in the company's assets by virtue of allowing the company to avoid expenditure that it would otherwise have to bear. By saving it that expense, the advantage of such a loan helps to strengthen the company's economic potential and must therefore be regarded as likely to increase the value of the rights in the recipient company.⁷⁶⁸

An increase in the capital of a capital company by way of the capitalization of profits or permanent or temporary reserves refers to transactions which assume that there is a transfer for values leading to an increase in capital contributing to a strengthening of the economic potential of the company.

On the other hand, a Member State is not entitled to charge capital duty solely on the basis of an increase in the nominal capital which does not contribute to such strengthening.⁷⁶⁹

b. Restructuring Operations

"Restructuring operations" (which, for the purposes of the Capital Duty Directive, are not considered to be contributions of capital) include the following transactions:

(i) The transfer by one or more capital companies of all their assets and liabilities, or one or more branches of activity⁷⁷⁰ to one or more capital companies that are in the process of being formed or are already in existence, provided the consideration for the transfer consists, at least in part, of securities representing the capital of the acquiring company(ies); and

(ii) The acquisition, by a capital company that is in the process of being formed or is already in existence, of shares representing a majority of the voting rights of another capital company, provided the consideration for the shares acquired consists, at least in part, of securities representing the capital of the former company.⁷⁷¹

⁷⁶⁴ Case C-49/91, *Weber Haus*.

⁷⁶⁵ Case C-15/89, *Deltakabel*.

⁷⁶⁶ Case C-38/88, *Siegen*.

⁷⁶⁷ Case C-492/10, *Immobilien Linz*.

⁷⁶⁸ See Case C-392/00, *Norddeutsche Gesellschaft zur Beratung und Durchführung von Entsorgungsaufgaben bei Kernkraftwerken*; see also, Case C-249/89, *Trave Schifffahrts-Gesellschaft* and Case C-287/94, *Frederiksen*.

⁷⁶⁹ See, e.g., Case 36/86, *Dansk Sparinvest*.

⁷⁷⁰ For this purpose, a "branch of activity" refers to an aggregate of assets and persons capable of contributing to the performance of a specified activity (Case C-50/91, *Commerz-Credit-Bank AG — Europartner v. Finanzamt Saarbrücken*).

⁷⁷¹ Capital Duty Directive, Art. 4(1). Where the majority of the voting rights is reached by means of two or more transactions, only the transaction via

"Restructuring operations" also include the transfer to a capital company of all the assets and liabilities of another capital company that is wholly owned by the former company.⁷⁷²

c. Issue of Certain Securities and Debentures

The term "securities" refers to stocks, shares or other securities of the same type, or certificates representing such securities, by whomsoever issued.⁷⁷³

The term "debentures" refers to loans, including government bonds, raised by the issue of debentures or other negotiable securities, by whomsoever issued.

*B. Applicable Taxation Rules**1. General Prohibition on the Imposition of Indirect Taxes*

Under Article 5(1) of the Capital Duty Directive, Member States may not subject capital companies to any form of indirect tax whatsoever with respect to:

- (i) Contributions of capital;
- (ii) Loans or the provision of services occurring as part of contributions of capital;
- (iii) Registration or any other formality required before the commencement of business to which a capital company may be subject by reason of its legal form;
- (iv) The alteration of the constituent instrument or regulations of a capital company, and in particular the following:

- The conversion of a capital company into a different type of capital company;
- The transfer from one Member State to another Member State of the center of effective management or the registered office of a capital company;
- The change in the objects of a capital company; or
- The extension of the period of existence of a capital company; or
- The restructuring operations referred to at XIV.A.2.b., above.

According to the title of the Capital Duty Directive ("concerning indirect taxes on the raising of capital") itself and the wording of Article 5(1)(a) of the Directive, the Directive only prohibits Member States from subjecting contributions of capital to "indirect tax". Thus, the harmonization provided for by the Directive does not concern direct taxes, which, like corporation tax, are in principle a matter for the Member States, in compliance with EU law.⁷⁷⁴

which the majority of voting rights is reached and any subsequent transactions are regarded as restructuring operations.

⁷⁷² Capital Duty Directive, Art. 4(2).

⁷⁷³ The term "issued" encompasses the first acquisition of securities immediately consequent upon their issue (Case C-415/02, *Commission v. Belgium*), such as the transfer of newly-issued securities into the clearance service on the occasion of a public offer (Case C-569/07, *HSBC Holdings and Vidacos*).

⁷⁷⁴ Case C-287/94, *Frederiksen*, C 287/94; Case C-113/99, *P. P. Handelsgesellschaft*.

Accordingly, Article 5(1)(a) of the Capital Duty Directive does not require Member States to exempt contributions of capital from all forms of direct tax. This is illustrated by *Viva Telecom Bulgaria*,⁷⁷⁵ in which case the Bulgarian tax authorities claimed, based on a domestic anti-abuse provision, that fictitious or deemed interest — on which a 10% withholding was due — should be imputed in the context of a convertible interest-free loan granted by a Luxembourg-based parent company to its Bulgarian subsidiary. The CJEU held that such withholding tax had to be regarded as a direct tax on income. Such a tax, which derived from the application of the national legislation on corporation tax, had as its chargeable event and its base the income that the Luxembourg parent company should have obtained under market conditions and, hence, was not within the scope of application of the Capital Duty Directive.

In the CJEU's view, the prohibition laid down in Article 5(1)(c) was justified by the fact that, although the taxes in question were not imposed on capital contributions as such, they were nevertheless imposed on account of formalities connected with a company's legal form. Being imposed on account of the instrument employed for raising capital, their continued existence would have similarly risked frustrating the aims of the Directive.⁷⁷⁶

Consequently, the prohibition must, in principle, be interpreted broadly as encompassing not only procedures that were formally required before a capital company commences business, but also formalities that were necessary for carrying on the business of such a company.⁷⁷⁷ It follows that a fee charged for rectification of the land register (that rectification being a direct consequence of the merger between the capital companies concerned) constituted a tax levied for a prior formality to which a legal person operating for profit might be subject by reason of its legal form.⁷⁷⁸

However, the case law of the CJEU demonstrates that the prohibition does not preclude a tax payable annually on account of the registration of an undertaking with a chamber of commerce and industry, since, to the extent the event that gives rise to such tax is not the registration of the company or the legal person that owns an undertaking but the registration of the undertaking itself, the tax is unrelated to the legal form of the entity that owns the undertaking and is not, therefore, linked to formalities to which capital companies may be subject by reason of their legal form.⁷⁷⁹

In *Air Berlin*,⁷⁸⁰ the CJEU held Article 5(1)(c) precluded the taxation of a transfer of shares, whereby the legal title to shares that had been newly issued on an increase in capital had

been transferred to a clearance service for the sole purpose of offering those new shares for purchase. The same holds true where legislation of a Member State enables an operator of a clearance service, when it receives approval from the taxation authority, to elect that no stamp duty is payable on the initial transfer of shares into the clearance service but that a stamp duty reserve tax is instead charged on each subsequent sale of shares.

In the CJEU's opinion, the prohibition for Member States from charging capital duty on "the conversion of a capital company into a different type of capital company" necessarily concerned conversions of companies without any increase in capital (conversions with an increase in capital being covered by the Capital Duty Directive). The objective pursued by that prohibition would be compromised if, on the conversion of a capital company into a different type of capital company, other taxes with the same effect as capital duty could be charged.⁷⁸¹

Further to Article 5(2) of the Capital Duty Directive, Member States must also refrain from imposing any form of indirect tax whatsoever on:

(i) The creation, issue, admission to quotation on a stock exchange or making available on the market of, or dealing in, stocks, shares or other securities of the same type, or certificates representing such securities, by whomsoever issued; or

(ii) Loans,⁷⁸² including government bonds, raised by the issue of debentures or other negotiable securities, by whomsoever issued, or any formalities relating thereto, or the creation, issue, admission to quotation on a stock exchange or making available on the market of, or dealing in, such debentures or other negotiable securities.

*Gielen*⁷⁸³ concerned the question as to whether Art. 5(2) was to be interpreted as precluding the taxation of the compulsory conversion (prescribed by law) of bearer securities into registered securities or dematerialized securities, and, if so, whether such a tax could be justified based on Capital Duty Directive, Art. 6 (see XIV.B.3., below).

The CJEU first reminded that Art. 5(1) prohibited any form of indirect tax whatsoever with respect to contributions of capital.

The Court subsequently held that the Capital Duty Directive, Art. 5(2)(a) and (b), prohibited Member States from subjecting to indirect tax, in any form whatsoever:

(i) The creation, issue, admission to quotation on a stock exchange, making available on the market of, or dealing in, stocks, shares or other securities of the same type, or certificates representing such securities, by whomsoever issued; and

(ii) Among others, loans, including government bonds, raised by the issue of debentures or other negotiable securities.

⁷⁷⁵ Case C-257/20, *Viva Telecom Bulgaria*, referring, by analogy, to Case C-113/99, *P. P. Handelsgesellschaft*, and Case C-22/03, *Optiver and Others*. On the relationship between the Fundamental Freedoms and [the relevant] Directive, see II.E.6.f., above.

⁷⁷⁶ Case C-2/94, *Denkavit Internationaal and Others*; Case C-188/95, *Fantask*; Case C-347/96, *Solred*; Joined Cases C-216/99 and C-222/99, *Prisco and CASER*.

⁷⁷⁷ See Case C-466/03, *Albert Reiss Beteiligungsgesellschaft*; Case C-188/95, *Fantask and Others*; Case C-56/98, *Modelo ("Modelo I")*; Case C-19/99, *Modelo ("Modelo II")*; Case C-134/99, *IGI*; Case C-206/99, *SONAE*; Case C-426/98, *Commission v. Greece*.

⁷⁷⁸ Case C-264/04, *Badischer Winzerkeller*.

⁷⁷⁹ See Case C-2/94, *Denkavit Internationaal and Others*; Case C-443/09, *Grillo Star Fallimento*; see also Case C-468/12, *Ciesse* (Order of the Court).

⁷⁸⁰ Case C-573/16, *Air Berlin*.

⁷⁸¹ See Case 524/13, *Eyck Braun*.

⁷⁸² See, e.g., Case 15/88, *Maxi Di*. The prohibition on the taxation of debenture loans also applies to the duty on notarial deeds recording the repayment of loans; such a duty cannot come within the exceptions provided for in Capital Duty Directive, Art. 6(1) (see below) — see, Joined Cases C-31/97 and C-32/97, *Fuerzas Eléctricas de Catalunya SA (FECSA) and Autopistas Concesionaria Española*.

⁷⁸³ See, e.g., Case C-299/13, *Gielen*.

rities, by whomsoever issued, or any formalities relating thereto.

According to the Court, referring to earlier rulings,⁷⁸⁴ the prohibition on the taxation of transactions for the raising of capital also applied to transactions not expressly covered by that prohibition, where such taxation was tantamount to taxing a transaction forming an integral part of an overall transaction with regard to the raising of capital. Hence, the levying of a tax on the compulsory conversion of bearer shares into dematerialized or registered securities (such as the Belgian tax at issue) effectively amounted to taxing the very issue of the underlying securities as it formed an integral part of an overall transaction with regard to the raising of capital.

Finally, such a tax could not be justified by Art. 6(1) (see below) as, in the course of the conversion, bearer stocks were converted into dematerialized securities or registered securities without a transfer of a right from a first holder to a second holder.

While it was true that it could not be validly maintained that the levying of a duty on securities intermediaries on their gross profits from activities related to securities was not a tax, such a duty did not constitute a tax prohibited by the Capital Duty Directive, since it did not fall within the scope of the Directive. As the taxable base was made up of the gross profits made by the securities intermediaries in the exercise of various activities, the duty was more in the nature of a direct tax on income and therefore fell within a category of taxes not covered by the Capital Duty Directive.⁷⁸⁵

2. Authorized Duties and Taxes

Notwithstanding the general prohibition discussed in XIV.B.1., above, Article 6(1) of the Capital Duty Directive authorizes Member States to charge the following duties and taxes:

- (i) Duties on the transfer of securities, whether or not charged at a flat rate;
- (ii) Transfer duties, including land registration taxes, on the transfer, to a capital company, of a business or immovable property⁷⁸⁶ situated within its territory;
- (iii) Transfer duties on assets of any kind transferred to a capital company, to the extent the property is transferred for consideration other than shares in the company;
- (iv) Duties on the creation, registration or discharge of mortgages or other charges on land or other property;
- (v) Duties in the form of fees or dues; and
- (vi) Value added tax (VAT).

The exception contained in Article 6(1)(a) employs a clear distinction between an issue of securities, which cannot be subjected to any charge or tax other than that provided for by law, and the transfer of such securities, which, by contrast, may be subjected to such a tax or duty.⁷⁸⁷

⁷⁸⁴ See Joined Cases C-31/97 and 32/97, *FECSA and ACESA* and Case C-415/02, *Commission v. Belgium*.

⁷⁸⁵ Case C-22/03, *Optiver and Others*; compare Case C-287/94, *Frederiksen* and Case C-113/99, *P.P. Handelsgesellschaft*.

⁷⁸⁶ See, e.g., Case C-287/94, *Società Immobiliare SIF*.

According to the CJEU, the levying of tax or duty on the initial acquisition of a newly-issued security amounts in reality to taxing the very issue of that security as it forms an integral part of an overall transaction with regard to the raising of capital (the issue of a security is not an end in itself and has no point until that security finds an investor).⁷⁸⁸ Therefore, the initial acquisition of securities immediately following their issue cannot be considered to constitute a “transfer of securities” and, accordingly, a tax on that initial acquisition cannot be regarded as an authorized duty or tax under the Directive.⁷⁸⁹

On the other hand, the ability of Member States to impose taxes on the transfer of securities is not limited to stock exchange transactions only, but must be interpreted as allowing a tax to be charged in the event of a transfer of shares irrespective of whether:

- (i) The company issuing the shares is listed on a Stock Exchange; and
- (ii) The shares are transferred on the Stock Exchange or directly from the transferor to the transferee.⁷⁹⁰

As regards the exception in Article 6(1)(e), according to settled CJEU case law, the distinction drawn between taxes prohibited by the Directive and duties paid by way of fees or dues that can lawfully be imposed implies that the latter comprise only remuneration the amount of which is calculated based on the cost of the service rendered.⁷⁹¹

Where the amount payable is wholly unrelated to the cost of the service in question or is calculated by reference not to the cost of the transaction for which it constitutes the consideration, but to all the operational and capital costs incurred by the office responsible for that transaction, it must be regarded as a tax falling exclusively within the prohibition laid down in the Directive.⁷⁹²

“Fees or dues” do not cover a charge collected for drawing up a notarized-attested act recording an increase in the share capital or an amendment to the statutes of a capital company, the amount of which increases in direct proportion to the share capital raised and with respect to which there is no upper limit.⁷⁹³

Duties paid by way of fees or dues may be payment collected by way of consideration for transactions required by law in the public interest such as, for example, the registration of capital companies. The amount of such duties, which may vary according to the legal form taken by the company, must be calculated based on the cost of the transaction, which may be assessed on a flat-rate basis, but may not be calculated based on

⁷⁸⁷ See Case C-569/07, *HSBC Holdings and Vidacos*; Case C-487/09, *Immogolf*.

⁷⁸⁸ Case C-415/02, *Commission v. Belgium*.

⁷⁸⁹ Case C-569/07, *HSBC Holdings and Vidacos*.

⁷⁹⁰ Case C-236/97, *Skatteministeriet/Aktieselskabet Forsikringsselskabet Codan*.

⁷⁹¹ See, e.g., Case C-197/03, *Commission v. Italy*.

⁷⁹² See Joined Cases C-71/91 and C-178/91, *Ponente Carni and Cispadana Costruzioni*; Case C-56/98, *Modelo* (“Modelo I”); Case C-206/99 *SONAE*; see also Order of the Court in Case 264/00, *Gründerzentrum*.

⁷⁹³ Case C-19/99, *Modelo* (“Modelo II”).

all the running and capital costs of the department responsible for effecting the registration.⁷⁹⁴

The exception in Article 6(1)(f) implies that the Capital Duty Directive does not preclude, for example, the levying on capital companies of a tax such as a tax on companies' net assets, even where the tax relates to that part of the net assets that consists of the company's capital, as recorded annually in the balance sheet.⁷⁹⁵

By contrast, the levying of a tax on the compulsory conversion of bearer shares into dematerialized or registered securities, which amounts in reality to taxing the very issue of the underlying securities as it forms an integral part of an overall transaction with regard to the raising of capital cannot be justified by Art. 6(1) as, in the course of the conversion, bearer stocks are converted into dematerialized securities or registered securities without the transfer of a right from a first holder to a second holder.⁷⁹⁶

According to Article 6(2) of the Capital Duty Directive, the amount charged by way of the duties and taxes listed in Article 6(1)(b) to (e) may not vary according to whether or not the center of effective management or the registered office of the capital company is situated within the territory of the Member State charging the duties or taxes. That amount may not exceed the amount of duties or taxes applicable to like transactions that take place within the Member State charging them.

Article 6 of the Capital Duty Directive is to be strictly interpreted.⁷⁹⁷

3. Derogatory Regime — Levying of Capital Duty in Member States Charging Capital Duty as of January 1, 2006

A Member State that charged a capital duty as of January 1, 2006 may, subject to certain conditions, continue to do so.⁷⁹⁸

In these circumstances, capital duty must be charged at a single rate that may not exceed the rate applied by the Member State concerned on January 1, 2006, it being understood that the applicable rate is, in any event, capped at 1%. Where, after that reference date, the Member State reduces the rate applied, it may not reintroduce a higher rate.⁷⁹⁹

With a view to avoiding double taxation, capital duty is chargeable in the Member State (continuing to charge capital duty) where the center of effective management of the capital company is situated at the time when the qualifying contribution of capital is made.⁸⁰⁰

The determination of the basis of assessment for capital duty depends on the transaction in the context of which the capital contribution occurs.⁸⁰¹

- (i) The formation of a capital company, an increase in the capital of a capital company by way of the contribution of

assets of any kind or an increase in the assets of a capital company by way of the contribution of assets of any kind in consideration not of shares in the capital or assets of the company, but of rights of the same kind as those of members, such as voting rights, a share in the profits or a share in the surplus on liquidation.

The basis of assessment for capital duty corresponds to the actual value of assets of any kind contributed or to be contributed by the members, after the deduction of liabilities assumed and expenses borne by the company as a result of each contribution.⁸⁰²

The charging of capital duty may be postponed until the contributions have been effected.⁸⁰³

- (ii) The conversion into a capital company of a company, firm, association or legal person that is not a capital company, the transfer from a third country to a Member State of the center of effective management of a capital company whose registered office is in that third country, or the transfer from a third country to a Member State of the registered office of a capital company whose center of effective management is in that third country.

The basis of assessment for capital duty is the actual value of assets of any kind belonging to the company at the time of the conversion or transfer, after the deduction of liabilities and expenses for which the company is responsible at that time.

- (iii) An increase in the capital of a capital company by way of the capitalization of profits or permanent or temporary reserves.

The basis of assessment for capital duty is the nominal amount of the increase.

- (iv) An increase in the assets of a capital company through the provision of services by a member that does not entail an increase in the company's capital, but results in a variation in the rights in the company or may increase the value of the company's shares.

The basis of assessment for capital duty corresponds to the actual value of the services provided, after deduction of the

⁷⁹⁴ Joined Cases C-71/91 and C-178/91, *Ponente Carni SpA and Cispadana Costruzioni SpA*).

⁷⁹⁵ Joined Cases C-279/99, C-293/99, C-296/99, C-330/99 and C-336/99, *Petrolvilla & Bortolotti and Others*.

⁷⁹⁶ Case C-299/13, *Gielen*; see also XIV.B.1., above.

⁷⁹⁷ Case C-443/09, *Grillo Star Fallimento*.

⁷⁹⁸ Capital Duty Directive, Art. 7(1).

⁷⁹⁹ Capital Duty Directive, Art. 8.

⁸⁰⁰ Capital Duty Directive, Art. 10.

⁸⁰¹ Capital Duty Directive, Art. 11.

⁸⁰² See Case 161/78, *Conradsen*, in which the CJEU specified that the capital duty must be charged on the "actual value" of the assets at the time at which they were contributed, and not on their book value, and that the "liabilities and expenses" that are deductible from the actual value of the contributions can only be those whose existence and amount are certain.

⁸⁰³ According to the CJEU, a Member State is not precluded from identifying the registration of an instrument recording an increase in the capital of a company as the point at which the chargeable event for capital duty occurs, provided there remains a connection between the levying of the duty and the actual contribution of assets to the company receiving them. If, at the time when such an instrument is executed, the actual contribution of assets has not been effected and it remains uncertain whether it will be effected, the Member State concerned cannot demand the payment of capital duty until the contribution has become definite. The principle of effectiveness must be interpreted as precluding national legislation that restricts, before the tax courts, the means of proving that no contribution was in fact effected to increase the capital of a company, in accordance with the company's resolution, to the production of a civil judgment that has become final declaring the registration null and void or annulling it, so that capital duty must in any event be paid and can be reimbursed only by means of the production of such a civil judgment (Case C-35/09, *Speranza*).

liabilities assumed and the expenses borne by the company as a result of the provision of such services.

(v) A loan taken up by a capital company, if the creditor is entitled to a share in the profits of the company, a loan taken up by a capital company with a member or a member's spouse or child, or a loan taken up with a third party that is guaranteed by a member, subject to the condition that such a loan has the same function as an increase in the company's capital.

The basis of assessment for capital duty is the nominal amount of the loan taken up.

In cases (i) and (ii), the actual value of the shares in the company allotted or belonging to each member may be used as the basis of assessment for capital duty, except where contributions are made solely in cash. The amount on which duty is charged may in no circumstances be less than the nominal amount of the shares in the company allotted or belonging to each member.

Certain items must be excluded from the basis of assessment for capital duty, namely:⁸⁰⁴

(i) In the case of an increase in capital:

(a) The amount of the assets belonging to the capital company that are allocated to the increase in capital and have already been subjected to capital duty;⁸⁰⁵ and

(b) The amount of loans taken up by the capital company that are converted into shares in the company and have already been subjected to capital duty.

(ii) At the option of the Member State concerned: the amount of the capital contributed by a member with unlimited liability for the obligations of a capital company, as well as the share of such a member in the company's assets (however, where a Member State exercises this power, any transaction as a result of which the liability of a member is limited to his/her share in the company's capital, in particular when the limitation of liability results from the conversion of a capital company into a different type of capital company, will be subject to capital duty).

⁸⁰⁴ Capital Duty Directive, Art. 12.

⁸⁰⁵ According to the CJEU, this exclusion must be interpreted as meaning that it applies irrespective of whether the assets in question are assets of the company that has had an increase in capital or assets coming from another company that have increased that capital (Case C-372/10, *Pak-Holdco*).

(iii) In the case of a contribution of capital in the context of an increase in the capital of a capital company by way of the contribution of assets of any kind, following a reduction in the company's capital as a result of losses sustained, that part of the contribution of capital that corresponds to the reduction in capital, provided the contribution of capital occurs within four years of the reduction in capital.

Under the derogatory regime, which is not subject to any time limitations, Member States may nonetheless exempt from capital duty contributions of capital made to:

(i) Capital companies that supply public services, such as public transport undertakings, port authorities or undertakings supplying water, gas or electricity, in cases in which the State or regional or local authorities own at least half of the company's capital; and

(ii) Capital companies that, in accordance with their regulations and in fact, pursue exclusively and directly cultural, social, relief or educational objectives.⁸⁰⁶

In addition, certain types of contributions of capital or capital companies may be the subject of exemptions or reductions in rates designed to achieve fairness in taxation, based on social considerations, or designed to enable a Member State to deal with special situations.⁸⁰⁷

If, at any time after January 1, 2006,⁸⁰⁸ a Member State:

(i) Discontinues the charging of capital duty, it may not reintroduce it;⁸⁰⁹

(ii) Discontinues the charging of capital duty on the contributions of capital referred to in Article 3(g) to (j) (see XIV.A.2.a., above), it may not reintroduce capital duty on such contributions of capital; or

(iii) Discontinues the charging of capital duty on the provision of fixed or working capital to a branch, it may not reintroduce a duty on the contributions of capital concerned.

⁸⁰⁶ Capital Duty Directive, Art. 13.

⁸⁰⁷ Capital Duty Directive, Art. 14.

⁸⁰⁸ Capital Duty Directive, Art. 7(2)–(4). The obligations of Member States deriving from Art. 7 concern every transaction falling within the scope of the Directive (Case C-377/13, *Ascendi Beiras Litoral e Alta, Auto Estradas das Beiras Litoral e Alta*).

⁸⁰⁹ Case C-377/13, *Ascendi Beiras Litoral e Alta, Auto Estradas das Beiras Litoral e Alta*; see also Case C-212/10, *Logstor ROR Polska*; Case C-366/05, *Optimus-Telecomunicações*.

XV. Code of Conduct for Business Taxation

A. General

Executive Summary

This Section discusses the 1997 Code of Conduct for Business Taxation, which focuses on harmful tax competition, and its 2022 successor.

After a brief historical overview of the genesis of the Code of Conduct (see XV.C.1., below), the Section continues with a description of the 1997 Code of Conduct for Business Taxation (see XV.C.1., below). This is followed by a contextualization of the 2022 Code of Conduct, which was adopted to meet new challenges posed by an increasingly globalized and digitalized economic environment.

To this end, the 2022 Code of Conduct covers, in addition to “business taxation” and “those measures which affect, or may affect, in a significant way the location of business activity in the EU,” preferential tax measures and tax features of general application that affect, or may affect, in a significant way the location of business activity in the European Union, including both laws or regulations and administrative practices (see XV.B., below).

Article 115 of the TFEU, along with Article 114 of the TFEU, constitutes the fallback residual legal basis for the approval of all legislation deemed necessary for the establishment and functioning of the internal market.

Unlike Article 114, however, Article 115 of the TFEU requires a unanimous vote. It is, arguably, the lack of a specific legal basis for harmonization and the need for a unanimous vote that remain problematic for the introduction of EU legislation in the area of direct corporate taxation.

Against this backdrop, the use of soft law (i.e., legally nonbinding instruments)⁸¹⁰ in direct taxation appears to be a pragmatic alternative approach. In its Communication “Tax Policy in the European Union — Priorities for the years ahead,”⁸¹¹ the Commission stated that the use of non-legislative approaches or “soft legislation” could be an additional means of making progress in the (direct) tax field.⁸¹²

The Code of Conduct for Business Taxation is a case in point, illustrating the use of “steering” soft law in the direct tax area.⁸¹³

⁸¹⁰ Apart from recommendations and opinions, listed in TFEU, Art. 288 as measures with nonbinding force, there are other instruments that fall within the scope of the soft law definition. These include resolutions, declarations, decisions of the representatives of the Member States in the Council and guidelines.

⁸¹¹ COM (2001) 260 final.

⁸¹² On the other hand, the Commission has increasingly used soft law to provide positive guidance in the form of interpretative or decisional soft-law instruments, inter alia on the implications of case law of the CJEU for Member States’ tax systems.

⁸¹³ “Steering” soft law instruments are aimed at establishing or giving further effect to Community objectives and policy or policy related areas.

B. The 2022 Code of Conduct

1. General

On November 8, 2022, the Council approved a revision of the Code of Conduct for Business Taxation (the “2022 Revised Code.”) The 2022 Revised Code is the subject matter of a Resolution of the Council and of the Representatives of the Governments of the Member States meeting within the Council (the “Resolution”).⁸¹⁴

The Resolution:

(i) Emphasizes that fair treatment within the EU and with respect to third countries and tax jurisdictions continues to be essential for the coherent implementation of the principles of the 1997 Code of Conduct;

(ii) Reiterates the willingness to keep the application of the Code as transparent as possible without jeopardizing the confidentiality required for a frank exchange of views and sensitive information between the members of the Code of Conduct Group, as well as with third countries and tax jurisdictions; and

(iii) Considers that the 1997 Code of Conduct should be revised to meet new challenges as efficiently as possible in an increasingly globalized and digitalized economic environment.

To this end, the 2022 Code of Conduct covers, in addition to “business taxation” and “those measures which affect, or may affect, in a significant way the location of business activity in the EU,” i.e.:

(i) Preferential tax measures (see XV.C.2.a., below); and

(ii) Tax features of general application that affect, or may affect, in a significant way the location of business activity in the European Union, including both laws or regulations and administrative practices.

2. Preferential Measures

For the purposes of the 2022 Code of Conduct, the term “preferential tax measures” refers to measures that provide for a significantly lower effective level of taxation, including zero taxation, than the levels of taxation generally applicable in the Member State in question. Such low levels of taxation may operate by virtue of the nominal tax rate, the tax base or any other relevant factor.

Preferential tax measures are to be regarded as potentially harmful and therefore covered by the Code. When assessing whether preferential tax measures are harmful, account should be taken of, among other issues, the following:

(i) Whether advantages are ring-fenced *de facto* or *de jure* from the domestic market, for example, they are accorded only to nonresidents or with respect to transactions carried out with nonresidents, or they do not affect the national tax base;

⁸¹⁴ Resolution of the Council and of the Representatives of the Governments of the Member States, meeting within the Council, on a revised Code of Conduct for Business Taxation (2022/C 433/01).

(ii) Whether advantages are granted even if there is no real economic activity or substantial economic presence within the Member State offering the tax advantages;

(iii) Whether the rules for determining profit with respect to activities within a multinational group of companies depart from internationally accepted principles, in particular the rules agreed upon within the OECD; or

(iv) Whether the tax measures lack transparency, including where legal provisions are relaxed at the administrative level in a non-transparent way.

3. Tax Features of General Application

For the purposes of the 2022 Revised Code, the term “tax features of general application” of a Member State refers to features that, in creating opportunities for double non-taxation or leading to the double or multiple use of tax benefits, in connection with the same expenses, amount of income or chain of transactions, are to be regarded as potentially harmful and therefore covered by the Code.

The term “tax features of general application” covers any relevant feature of a Member State’s domestic tax system that leads to lower tax liability, including no tax liability, other than the nominal tax rate or deferred taxation as a feature of a distribution tax system.

When assessing whether a tax feature of general application of a Member State is harmful, account should be taken of the following cumulative criteria and the existence of a direct causal link between them:

(i) The tax feature is not accompanied by appropriate anti-abuse provisions or other adequate safeguards and, as a result, leads to double non-taxation or allows the double or multiple use of tax benefits in connection with the same expenses, amount of income or chain of transactions; and

(ii) The tax feature affects in a significant way the location of business activity in the European Union.

When evaluating whether the tax feature is a significant factor in determining the location of business activity in the European Union, the Code of Conduct Group should take into account the fact that the location of business activity can also be influenced by circumstances other than tax features.

As an example, a general feature of a Member State’s tax regime might be the transfer pricing legislation allowing for taxation not in line with the arm’s-length principle, which may lead to double non-taxation.

4. Standstill and Rollback

The Resolution provides for:

(i) A standstill under which Member States commit themselves not to introduce new tax measures that are harmful within the meaning of the Code; and

(ii) A rollback provision under which Member States commit themselves to re-examining their existing laws and established practices and to amending such laws and practices as necessary with a view to eliminating any harmful tax measures, or to adopting appropriate anti-abuse provisions or other adequate safeguards in relation to harmful tax measures.

5. Review Process

The Resolution further sets out the following review process.

(i) Notification: The starting point of the review process (“Notification”) consists in Member States informing each other by the end of each calendar year of any existing and proposed tax measures that may fall within the scope of the Code and in relation to which they wish to obtain certainty about their compliance with the Code.

In the absence of such notification, Member States must provide, at the request of another Member State or the Commission, information on any tax measure that appears to fall within the scope of the Code. Where envisaged tax measures require parliamentary approval, such information need not be provided until after their announcement to Parliament.

Tax measures of a Member State that have not been so notified may be brought to the attention of the Group at the request of another Member State or the Commission. Before bringing such tax measures to the attention of the Group, the transmitting Member State or the Commission should inform the Member State concerned. With regard to tax features of general application, the transmitting Member State or the Commission should present to the Group any information that:

- Reasonably indicates the tax feature has at least one of the effects described above; and
- Can reasonably lead to the conclusion of a potentially significant impact on the location of business activities in the European Union.

(ii) Agreed description and assessment: Any Member State or the Commission may request the opportunity to discuss and comment on a tax measure of a Member State notified as set out above. Member States subsequently decide whether to follow up and prepare an agreed description of the measure, permitting an assessment to be made of whether the tax measure in question is harmful, in light of the effects it may have within the European Union.

The assessment must take into account all the above-referenced factors relevant to deciding whether the tax measure concerned qualifies as a preferential tax measure or a tax feature of general application.

In reviewing notified tax measures, the effects that they have on other Member States will also needed to be carefully evaluated, for instance, in the light of how the activities concerned are effectively taxed throughout the European Union, and to allow the Group to:

- Consider any relevant economic factors and impact data brought to its attention; and
- Take into account the size and openness of the economy of the Member State concerned.

Insofar as tax measures are used to support the economic development of particular regions, an assessment will be made of whether the measures are in proportion to, and targeted at, the aims sought. In assessing this, particular attention will be

paid to special features and constraints in the case of the outermost regions and small islands, without undermining the integrity and coherence of the EU legal order, including the internal market and common policies.

The Resolution acknowledges that some of the tax measures covered by the Code may fall within the scope of the provisions on State aid set out in Articles 107 to 109 of the TFEU. In cases where the Commission opens State aid proceedings, the Code of Conduct Group should suspend its examination of the measures concerned until the end of those proceedings. A preliminary description of the measure concerned, drafted by the Commission in close consultation with the Member State concerned, can be provided to the Code of Conduct Group. If necessary, a final description should be provided as soon as the State aid proceedings have ended.

6. Action to Combat Tax Avoidance and Evasion

Within the context of the action to combat tax avoidance and evasion, the Code of Conduct Group may, when deemed appropriate, submit to the Council for approval proposals for general guidance within the scope of its mandate, to the extent the proposed general guidance is not already covered by EU legislation. Once approved by the Council, the final guidance will be published. In particular, the Group will submit for approval by the Council proposals for guidance on specific tax features of general application that fall within the scope of the Code.

7. Application, Monitoring and Revision

With effect from January 1, 2023, the 2022 Code of Conduct replaced the 1997 Code of Conduct. However, with regard to tax features of general application (as defined above), the 2022 Code of Conducts only applies from January 1, 2024, and only in relation to measures enacted or modified on or after January 1, 2023.

To ensure the even and effective implementation of the 2022 Code of Conduct, the Council invites the Commission to report to it annually on:

- (i) The implementation of the Code; and
- (ii) The application of fiscal State aid.

The Council and the Member States will review the provisions of the Code, when appropriate, especially when there is a new international consensus on relevant issues.

8. Non-Cooperative Jurisdictions

The Code of Conduct Group is to assess third countries' tax systems within the context of the identification of the "non-cooperative jurisdictions" — see XXII., below.

C. History, Background & Development

1. Initial Development

In "Taxation in the European Union,"⁸¹⁵ the Commission proposed a new comprehensive approach to tax policy in the European Union.

The Commission warned against:

- (i) The unfair tax competition between Member States;
- (ii) The potential for "fiscal degradation," i.e., erosion of the tax base; and
- (iii) The over-taxation of labor as a result of Member States' attempts to attract mobile capital by means of tax incentives, necessitating a shift in the tax burden to the less mobile production factor (i.e., labor) with a view to raising more or less the same tax revenue.

In its paper, the Commission announced that it was "reflecting" on whether a minimum level of effective taxation (a "safety net") would be desirable "at a level which would not risk driving business or wealth out of the EU."⁸¹⁶

This led, in April 1996, to the appointment of a High-Level Group on taxation, made up of the personal representatives of the Ministers of Finance, which was given the task of reporting to the ECOFIN Council after due consideration and which resulted in the Commission presenting a second report on October 22 1996.⁸¹⁷ In this second report, the Commission emphasized the need to maintain a strategic overview of Member States' tax policies to reinforce cooperation at an EU level. It suggested that a Tax Policy Group, to be chaired by the Commission, should be established to this end.

The first session of the Tax Policy Group, held on March 11, 1997, concentrated on providing a degree of coordination to limit the damaging effects of tax competition on Member States.

The Group also focused on assisting the Commission in working out the details of a communication (adopted on October 1, 1997)⁸¹⁸ intended to set down the broad outline of a package of measures designed to curb harmful tax competition. The October 1997 communication subsequently formed the basis for discussions at the Luxembourg ECOFIN Council session

⁸¹⁵ Doc. No. SEC (96) 487 final, dated March 20, 1996. The Monti Paper was the next step after the Ruding Report of 1992, commissioned by the Commission and named after its chairman (Report of the Committee of Independent Experts on Company Taxation, Commission of the European Communities, March 1992 (Luxembourg, Office for Official Publications of the European Communities 1992)). This report contains a comprehensive study of corporate taxation in the European Union, pointing out the considerable differences between the national laws of the Member States with distorting effects. The findings were followed by a number of policy recommendations regarding, on the one hand, the elimination of the double taxation of cross-border income flows, and, on the other, the approximation of corporation taxes. One of the recommendations was the alignment of the domestic rules of the EU Member States with the OECD Transfer Pricing Guidelines.

⁸¹⁶ Doc. No. SEC (96) 487 final, at V.

⁸¹⁷ Taxation in the European Union: Report on the Evolution of Tax Systems, COM (96) 546 final.

⁸¹⁸ See Towards Tax Co-ordination in the European Union; a Package to Tackle Harmful Tax Competition, COM (97) 495 final, dated October 1, 1997; see also A Package to Tackle Harmful Tax Competition in the European Union, COM (97) 564 final, dated November 5, 1997.

of October 13, 1997, at which it was emphasized that political agreement on the final Commission communication should be reached at the December 1, 1997, ECOFIN Council session. To this end, the Tax Policy Group met on October 22, 1997 to discuss the Commission communication to the Council. It advised the Commission to reduce the list of measures to be proposed for tackling harmful tax competition, primarily by excluding indirect taxation from the final package.

These developments resulted in the adoption by the ECOFIN Council, on December 1, 1997, of a comprehensive package to tackle harmful tax competition (the “Tax Package.”) The key element of the Tax Package was an “invitation” extended to the Member States to commit to a Code of Conduct for Business Taxation (the “Code”) under which the Member States would undertake to refrain from adopting new tax regimes that could cause harmful tax competition and would further agree to gradually dismantle any harmful regimes that existed at the time.⁸¹⁹

2. The 1997 Code of Conduct for Business Taxation

a. “Harmful Tax Measures”

Paragraph A of the 1997 Code of Conduct for Business Taxation (the “1997 Code of Conduct,”) states that the Code:

- (i) “Covers business taxation;” and
- (ii) “Concerns those measures which affect, or may affect, in a significant way the location of business activity in the EU.”

There is no precise definition of “business activity” except that it includes “all activities carried out within a group of companies.” Tax measures falling within the scope of the Code include laws, regulations and administrative practices.

Paragraph B of the Code sets out the criteria for identifying tax measures deemed to be “harmful” for these purposes. It states that “tax measures which provide for a significantly lower effective level of taxation, including zero taxation, than those levels which generally apply in the Member States in question are to be regarded as potentially harmful and therefore covered by this Code.” This level of taxation can operate by virtue of:

- (i) The nominal tax rate;
- (ii) The tax base; or
- (iii) Any other relevant factor.

In other words, the Code is not aimed at the overall rate or level of corporate tax in an individual Member State. Rather, it is directed at targeted measures that reduce the level of tax paid below the usual level.

Paragraph B further provides that, for the purposes of assessing whether a tax measure is harmful, account should be taken of:

- (i) Measures that grant special tax advantages only to non-residents or that accord advantages only to transactions carried out with nonresidents;

- (ii) Measures that grant benefits in isolation (“ring-fencing”) from the domestic economy and have no impact on the national tax base;

- (iii) Tax advantages granted without any real economic presence or activity in the Member State being required (a substance-over-form type of concept);

- (iv) Rules for determining taxable income that differ from generally accepted norms, and particularly those of the OECD (effectively, a test of whether the arm’s length principle is being applied); and

- (v) A lack of transparency, in the sense that the tax legislation is applied in a fashion so flexible that benefits can effectively be obtained by specially favored taxpayers.

Formally, the 1997 Code of Conduct does not grant priority to any of the five criteria.

The adoption of the 1997 Code of Conduct by the Council as a resolution means that it is of a non-legal nature. The Code of Conduct is therefore not legally binding, as affirmed in its final recital in which it is emphasized that “the Code of Conduct is a political commitment and does not affect the Member States’ rights and obligations or the respective spheres of competence of the Member States and the EU resulting from the Treaty.”

On March 9, 1998, to initiate the work programs necessary to implement the Code, the Council established the Code of Conduct Group, a special group composed of a high-level representative and his or her alternate from each Member State and the Commission, charged with:

- (i) Identifying tax regimes deemed to be “harmful” in each of the Member States; and
- (ii) Overseeing the dismantling of all such regimes.⁸²⁰

On November 23, 1999, the Code of Conduct Group issued a report, known as the “Primarolo Report,” listing 66 harmful tax measures.⁸²¹

b. Standstill and Rollback of Harmful Tax Measures Under The 1997 Code of Conduct

By adopting the 1997 Code of Conduct, the Member States:

- (i) Politically committed themselves not to introduce new tax measures that are harmful (the “standstill” provision);⁸²²
- (ii) Made a commitment to an internal review and re-examination of their existing tax laws and practices in the light of the principles expressed in the Code;⁸²³ and

⁸²⁰ The Group was established in accordance with Code, para. H. The detailed procedural rules relating to its internal functioning are contained in the ECOFIN Council Communiqué; No. 2072 of March 9, 1998.

⁸²¹ Code of Conduct (Business taxation), Report of November 23, 1999 to the ECOFIN Council, SN 4901/99. It is worth noting that 47 dissenting opinions of various Member States are included in the footnotes to the Report.

⁸²² This is the standstill provision expressed in Code, para. C. It took immediate effect.

⁸²³ Code, para. M imposes an obligation on the Member States to promote the adoption of the Code in third countries.

⁸¹⁹ OJ C/002 of January 6, 1998, at 1.

(iii) Agreed to repeal or amend any laws or practices, as necessary, with a view to eliminating any harmful measures as soon as possible (the “rollback” provision).

As a matching commitment to the Code, many Member States urged the Commission to:

- (i) Re-examine its policy in the field of fiscal State aid; and
- (ii) Make full use of its powers under the Treaty to tackle the problem of harmful tax competition,

a call to which the Commission responded positively.

Based on the “harmful measures” list, it was agreed during the ECOFIN Council session of November 26/27, 2000,⁸²⁴ that the rollback process should commence with effect from January 1, 2003.

In practice, the rollback commenced before that date. Any decision to extend the effects of certain harmful measures beyond December 31, 2005 had to be made on a case-by-case basis, taking into account “particular circumstances.” No doubt, the threat of an action by the Commission on State aid grounds spurred Member States to modify the listed regimes.

3. *From the 1997 Code of Conduct to the 2022 Code of Conduct*

Within the context of its Tax Transparency Package presented on March 18, 2015, the Commission acknowledged that the 1997 Code of Conduct had been, despite its voluntary and inter-governmental nature, an important tool for challenging and eliminating harmful tax regimes.

However, according to the Commission, recent cases highlighted limitations in the scope of the Code and weaknesses in the mandate of the Code of Conduct Group. For example, in the debate over whether three Member States’ patent box regimes were harmful, the Group was initially unable to reach a deci-

sion, due to the fact that the criteria set out in the Code were inadequate for evaluating this modern type of tax incentive.

In the Commission’s opinion, tackling complex new challenges to fair taxation and safeguarding tax transparency required more decisive action by the Code of Conduct Group and more rigorous monitoring to ensure that Member States respected their commitments.

In its June 17, 2015 Communication to the European Parliament and the Council, *A Fair and Efficient Corporate Tax System in the European Union: 5 Key Areas for Action* (the “Action Plan,”)⁸²⁵ the Commission argued that:

(i) A number of Member States and stakeholders supported the idea of extending the mandate of the Code of Conduct Group and changing the working methods of the Group to enable it to react more efficiently to cases of harmful tax competition;⁸²⁶ and

(ii) The Commission was to make a proposal to introduce these reforms to the 1997 Code of Conduct, in close consultation with Member States.

On November 26, 2021, the Slovenian Council Presidency published a draft resolution on a revised Code of Conduct, expanding the scope of the assessments of Member States’ tax regimes to include evaluation of the general features of their tax systems. The change was endorsed by the majority of the Member States during the ECOFIN meeting on December 7, 2021. Hungary and Estonia initially rejected the agreement, disagreeing with the revisions. However, they eventually changed their positions. This resulted in the adoption of a revised Code of Conduct in November 2022 (see the discussion at B., above).

⁸²⁴ Ecofin Council session of November 26/27, 2000, Press Release 453 no. 13861/00.

⁸²⁵ COM (2015) 302 final; [see also](#) (SWD (2015) 121 final).

⁸²⁶ See, in the same vein, the Council Conclusions of March 8, 2016 (Press Release 108/16).

XVI. State Aid and Taxation

A. Legal Basis and Overview — Constituent Elements of the Concept of “State Aid”

Executive Summary

This Section focuses on the interplay between the State aid provisions enshrined in the TFEU and national tax measures of the Member States. The legal basis of the State aid rules is discussed and *prima facie* identification of the constituent elements of the concept of “State aid” is provided (XVI.A., below), with each of those elements being analyzed in further detail in terms of their respective (potential) relevance in the tax area (XVI.B., below).

The Section then addresses the potential ramifications of the State aid rules in the specific case of tax rulings issued by the Member States. This has become the subject of attention as, beginning in 2013, the Commission has been carrying out inquiries into the compatibility of tax ruling practices with State aid. The discussion includes an analysis of the intervening Commission decisions to date and the judicial review of these decisions by the EU General Court, and as the case may be, the CJEU. Cases discussed include Fiat, Starbucks, the Belgian excess profit exemption, Apple, Amazon, Engie, McDonald’s, and the UK CFC group financing exemption (XVI.C., below).

The Section continues with a summary discussion of the minimis aid rules (XVI.D., below), exemptions from the prohibition on State aid (XVI.E., below), certain procedural rules (specifically those dealing with existing versus new State aid) (XVI.F., below). After a discussion of the recovery of unlawful State aid (XVI.G., below), the Section ends with an analysis of the Commission recommendation addressing the interplay between the State aid rules and the list of non-cooperative jurisdictions (XVI.H., below).

According to Articles 107 to 109 of the TFEU, State aid is, in principle, incompatible with the internal market.

The primary substantive article is Article 107(1), which states that: “any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favoring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market.”

The prohibition on State aid in Article 107(1) is addressed solely to the Member States.

As such, State aid does not have direct effect and, consequently, it does not:

- (i) Confer any rights on; or
- (ii) Create any obligations for, individuals.⁸²⁷

⁸²⁷ Case 77/72, *Capolongo*.

In applying the Community rules on State aid, it is irrelevant whether the measure is a tax measure, since Article 107(1) applies to all aid measures “in any form whatsoever.”

It is the Commission’s role to carry out a review of all systems of aid and aid proposals in the Member States, and to take a decision on each new aid scheme. Through such means as block exemptions and *de minimis* rules, the Commission hopes to reduce its caseload to be better positioned to focus on larger, competition-distorting aid schemes.

However, there are exceptions to this principle, and considerable State aid is in fact approved each year in accordance with rules established pursuant to the TFEU:

(i) Article 107(2) of the TFEU lists the categories of State aid that *are* compatible with the internal market (including aid having a social character and aid granted as a result of natural disasters); and

(ii) Article 107(3) of the TFEU, which has far more practical relevance, lists the kinds of State aid that *may* be considered compatible with the internal market.

The Commission Notice on the notion of State aid as referred to in Article 107(1) of the TFEU, published on July 19, 2016 in the Official Journal (the “State Aid Notice,”)⁸²⁸ presents “the Commission’s understanding of Article 107(1) of the TFEU, as interpreted by the CJEU and the General Court.”⁸²⁹

The Commission sets out how the notion of State aid should be construed in relation to issues that have not yet been considered by the CJEU or the General Court. However, the Commission’s views set out in the State Aid Notice are without prejudice to the interpretation of the notion of State aid by the CJEU and the General Court, as the primary reference for interpreting the Treaty is always the case law of these courts.⁸³⁰

Overall, the main objective of the State Aid Notice is to contribute to a more consistent application of the concept of aid and clarify the different constituent elements of the notion of State aid, i.e.;

- (i) The existence of an undertaking;
- (ii) The imputability of the measure to the State;
- (iii) The financing of the measure through State resources;
- (iv) The granting of an advantage;
- (v) The selectivity of the measure; and
- (vi) The effect of the measure on competition and trade between Member States.⁸³¹

⁸²⁸ Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union, C/2016/2946, OJ C 262, July 7, 2016. This Communication replaces: (i) Commission Communication to the Member States 93/C-307/03 on the application of Articles 92 and 93 of the EEC Treaty and of Article 5 of Commission Directive 80/723/EEC to public undertakings in the manufacturing sector (OJ C 307, November 13, 1993, p. 3); (ii) Commission Communication on State aid elements in sales of land and buildings by public authorities (OJ C 209, July 10, 1997, p. 3); and (iii) Commission Notice on the application of the State aid rules to measures relating to direct business taxation (OJ C 384, December 10, 1998, p. 3).

⁸²⁹ State Aid Notice, para. 3.

⁸³⁰ Case C-194/09, *Alcoa Trasformazioni v. Commission*.

⁸³¹ State Aid Notice, para. 5.

The State Aid Notice extends to 50 pages, of which more than six pages, in Section 5 on selectivity, pay particular attention to tax measures.

B. The Concept of State Aid in the Form of Tax Measures

Tax measures fall within the ambit of the prohibition laid down in Article 107(1) of the TFEU if they:

- (i) Constitute aid;
- (ii) Are granted by a Member State or through State resources;
- (iii) Favor certain undertakings or the production of certain goods; and
- (iv) Distort competition and affect trade between the Member States.

1. “Aid”

“Aids” are:

- (i) “Benefits;”⁸³²
- (ii) “Gratuitous advantages;”⁸³³
- (iii) “Decisions of Member States by which the latter, in pursuit of their own economic and social objectives, give by unilateral and autonomous decision, undertakings or other persons resources or procure for them advantages intended to encourage the attainment of the economic or social objectives sought;”⁸³⁴
- (iv) “Positive benefits, such as subsidies themselves, [and] also measures which, in various forms, mitigate the charges which are normally included in the budget of an undertaking and which, without therefore being subsidies in the strict meaning of the word, are similar in character and have the same effect;”⁸³⁵ and
- (v) “An economic advantage which it [the recipient] would not have obtained under normal market conditions.”⁸³⁶

Thus, the core element of the concept of a tax measure qualifying as State aid is that:

- (i) It confers an advantage or a benefit on its recipient;
- (ii) Without counterpart from the latter.

In other words, the measure must confer on its recipients an advantage that relieves them of charges ordinarily borne by such recipients.

To this end, it is imperative to determine the reference point in the scheme in question — the “general tax system” — against which that advantage is to be compared (see the discussion on the selectivity criterion in XVI.B.3.d., below). The advantage must be examined on an *ex-ante* basis, having regard to the information available at the time the intervention was decided upon.⁸³⁷

⁸³² Case 173/73, *Commission v. Italy*.

⁸³³ Case 78/76, *Steinike & Weinlig v. Germany*.

⁸³⁴ Case 61/79, *Amministrazione delle Finanze dello Stato v. Denkavit*.

⁸³⁵ Case C-200/97, *Ecotrade*.

⁸³⁶ Case C-39/94, *SFEI v. La Poste*.

Under that approach, various types of fiscal advantages can be characterized as State aid (provided the other constitutive conditions of State aid are also satisfied):⁸³⁸

- (i) A tax concession or tax exemption that reduces an undertaking’s liability towards the State;
- (ii) Tax credits;
- (iii) Reduced rates of tax;
- (iv) The deferral of an obligation to pay tax; and
- (v) A tax amnesty.

A tax measure amounts to “aid” if it provides the beneficiary with an advantage consisting of a reduction in its tax burden, whether by means of:

- (i) A reduction in the tax base;
- (ii) A total or partial reduction in the amount of tax to be paid; or
- (iii) Any other special tax treatment (such as the deferral or cancellation of tax).

The case law of the CJEU sets forth a wide array of tax measures that (may) amount to State aid:

- (i) Measures that reduce the tax base by providing special tax deductions (for example, special depreciation regimes, derogatory regimes for provisions, mechanisms for exceptional loss-carryovers and exclusions from the tax base of profits transferred to certain reserves)⁸³⁹ or regimes for the lump-sum determination of the tax base;⁸⁴⁰
- (ii) Measures reducing the amount of taxes owed;
- (iii) Measures granting a deferral, cancellation or special rescheduling of tax debts;
- (iv) Tax reductions in the form of tax credits,⁸⁴¹ tax exonerations,⁸⁴² reduced tax rates⁸⁴³ or tax refunds; and
- (v) Measures causing the use of tax proceeds to grant aid to certain undertakings or to make a public service available to certain undertakings for no consideration.⁸⁴⁴

⁸³⁷ State Aid Notice, para. 78); see also Case C-124/10 P, *EDF*; Case C-357/14 P, *Electrabel and Dunamenti Eromu*; Case C-362/19 P, *F.C. Barcelona*.

⁸³⁸ Obviously, given the diversity of national tax schemes and the overall lack of real common tax standards among Member States, there is no possible exhaustive classification of all tax measures that can constitute State aid.

⁸³⁹ Case C-156/98, *Germany v. Commission*; Case C-394/01, *France v. Commission* (specific investment deduction); Joined Cases C-78/08 to C-80/08, *Paint Graphos and Others* (exclusion from tax base of certain reserves).

⁸⁴⁰ Joined Cases C-182/03 and C-217/03, *Belgium v. Commission and Forum 187 v. Commission* (Belgian coordination centers); see also Case C-519/07, *Commission v. Koninklijke Friesland Foods* (Dutch regime applicable to group financial activities).

⁸⁴¹ Case C-6/97, *Italy v. Commission*.

⁸⁴² Joined Cases C-78/08 to C-80/08, *Paint Graphos and Others*; see Case C-387/92, *Banco de Credito*. However, if the exoneration derives from the application of EU legislation, it cannot amount to State aid: Case T-351/02, *Deutsche Bahn v. Commission*.

⁸⁴³ Case C-458/09 P, *Italy v. Commission*.

⁸⁴⁴ Case C-126/01, *Gemo*; Joined cases C-34/01 to C-38/01, *Enirisorse*; Case-33/07, *Ste Regie Networks*. The link that unites a tax and a State aid for this purpose must be compelling (Case C-175/02, *Pape*), which requires an appreciation from both a legal and economic point of view (Case C-174/02, *Streekgewest Westelijk Noord-Brabant*; Case C-266/04 to C-270/04, C-276/04

Tax rulings and tax settlements may amount to State aid — see the separate discussion in XVI.C., below.

The method by which aid is financed may render the entire aid scheme incompatible with the EU market. Thus, aid cannot be considered separately from the effects of its method of financing.⁸⁴⁵ The Commission must take into account the method by which the aid is financed, where that method forms an integral part of the measure. It follows that a tax that has been exclusively introduced to finance aid may also qualify as aid, provided the benefit arising from the tax is systematically allocated to finance the aid.⁸⁴⁶

In addition, for a tax, or part of a tax, to be regarded as forming an integral part of an aid measure, it must be hypothecated to the aid measure under the relevant national rules.⁸⁴⁷ In the event of such hypothecation, the revenue from the tax has a direct impact on the amount of the aid and, consequently, on the assessment of the compatibility of the aid with the common market.⁸⁴⁸

2. “Granted by the State or Through State Resources”

a. General

For aid to be “State aid”, it must be granted, directly or indirectly, through State resources.

“State resources” includes all public sector resources, including resources from intra-State entities (decentralized, federated, regional or other).⁸⁴⁹ Whether an institution within the public sector is autonomous is irrelevant.

- Funds provided by the central bank of a Member State to specific credit institutions generally imply the transfer of State resources.⁸⁵⁰
- Resources from public undertakings also constitute State resources within the meaning of Article 107(1) of the Treaty because the State is capable of directing the use of those resources.⁸⁵¹
- Transfers within a public group may also constitute State aid if, for example, resources are transferred from the parent company to its subsidiary (even if they constitute a single undertaking from an economic point of view).⁸⁵²

and C-321/04 to C-325/04, *Casino France*; Joined cases C-393/04 and C-41/05, *Air Liquide Belgium*).

⁸⁴⁵ Case 47/96, *France v. Commission*.

⁸⁴⁶ See, e.g., Joined Cases C-261/01 and C-262/01, *van Calster and Cleeren*.

⁸⁴⁷ Joined Cases C-393/04 and C-41/05, *Air Liquide*; Case C-75/18, *Vodafone*; Case C-323/18, *Tesco*.

⁸⁴⁸ Case C-175/02, *Pape*; Case C-174/02, *SWNB*; Case 47/69, *France v. Commission*.

⁸⁴⁹ Case 248/84, *Germany v. Commission*.

⁸⁵⁰ See Communication from the Commission on the application, from August 1, 2013, of State aid rules to support measures in favor of banks in the context of the financial crisis (‘Banking Communication’) (OJ C 216, 30.7.2013, p. 1), in particular point 62. However, the Commission made it clear that where a central bank reacts to a banking crisis with general measures open to all comparable market players in the market (e.g., lending to the whole market on equal terms) rather than with selective measures in favor of individual banks, such general measures often fall outside the scope of State aid control.

⁸⁵¹ Case C-482/99, *France v. Commission (Stardust)*; see also Case C-278/00, *Greece v. Commission* and Joined Cases C-328/99 and C-399/00, *Italy and SIM 2 Multimedia SpA v. Commission*.

⁸⁵² Case C-39/94, *SFEI and Others*.

The fact that a measure granting an advantage is not financed directly by the State, but by a public or private body established or appointed by the State to administer the aid, does not necessarily mean that the measure is not financed through State resources.

A measure adopted by a public authority and favoring certain undertakings or products does not lose the character of a gratuitous advantage by virtue of the fact that it is wholly or partially financed by contributions imposed by the public authority and levied on the undertakings concerned.⁸⁵³

“State resources” also include the financial resources of a private law undertaking controlled by the State or a State body.

However, the mere fact that the body granting the advantage in question is controlled by the State is not in itself sufficient to allow the conclusion that the advantage constitutes State aid.⁸⁵⁴

b. Direct Versus Indirect State Aid

State aid must be granted “directly or indirectly”⁸⁵⁵ through State resources.

(i) Tax aid is direct where it is granted by the State, which includes not only central governments and national tax authorities but also infra-State bodies that enjoy taxing powers.

(ii) Tax aid is indirect where it is granted through State resources, i.e., through funds under State control or through public funds granted by non-State bodies.⁸⁵⁶

Thus, the relevant element in assessing the “through State resources” criterion is the charge on the public account, meaning that the aid concerned must necessarily involve a “cost” for the Member State’s budget, which in tax matters generally takes the form of a loss of tax revenue.

Although it is now settled case law that the commitment of State resources is one of the constitutive elements of State aid and there must, therefore, be a charge on the State budget, it has not always been so.

In its early case law, the CJEU seemed more inclined to identify the State origin of a measure either by:

- The public nature of the resources used to finance it; or
- The fact that it was attributable to the State.⁸⁵⁷

Thus, in a 1985 judgment, the Court expressly held that “aid need not necessarily be financed from State resources to be classified as State aid.”⁸⁵⁸ The CJEU confirmed this approach a few years later in *Kwekerij van der Kooy and Others v. Com-*

⁸⁵³ Case 78/76, *Steinike & Weinlig*.

⁸⁵⁴ Case C-482/99, *France v. Commission*; Joined Cases C-328/99 and C-399/00, *Italy and SIM 2 Multimedia v. Commission*.

⁸⁵⁵ Indirect advantages should be distinguished from the merely secondary economic effects that are inherent in almost all State aid measures (State Aid Notice, para. 116).

⁸⁵⁶ Case 82/77, *Van Tiggele*; Joined Cases C-72/91 and C-73/91, *Sloman Neptun*; Case C-189/91, *Kirsammer-Hack*; Joined Cases C-52/97, C-53/97 and C-54/97, *Viscido*; Case C-200/97, *Ecotrade*; Case C-295/97, *Piaggio*; Case C-379/98, *PreussenElektra*.

⁸⁵⁷ See Opinion of Advocate General Mengozzi in Joined Cases C-399/10 P and C-401/10 P, *Bouygues SA and Bouygues Télécom SA v. Commission and Others*.

⁸⁵⁸ Case C-290/83, *Commission v. France*.

mission⁸⁵⁹ and, in 1988, the Court described the approach as “settled case law.”⁸⁶⁰

However, since the judgment in *Sloman Neptun*,⁸⁶¹ the Court has clearly taken the opposite view. Rejecting the argument put forward by the Commission (based on the case law set out above) and contrary to the Opinion of Advocate General Darmon, the Court held in that judgment that “only advantages which are granted directly or indirectly through State resources are to be regarded as State aid within the meaning of Article [107(1) of the TFEU]” and that “the wording of this provision itself (...) show[s] that advantages granted from resources other than those of the State do not fall within the scope of the provisions in question.”

In other words:

- (i) The granting of an advantage directly or indirectly through State resources; and
- (ii) The imputability of such a measure to the State

are two separate and cumulative conditions that must be fulfilled for State aid to exist.⁸⁶² Since then, the Court has consistently adhered to its new position.⁸⁶³

c. State Aid Notice Indicators

The State Aid Notice, which refers extensively to the case law of the CJEU (particularly to *France v. Commission (Stardust)*),⁸⁶⁴ lists the following possible indicators for establishing whether a measure is imputable:

- (i) The fact that the body in question could not make the contested decision without taking account of the requirements of the public authorities;
- (ii) The presence of factors of an organic nature that link the public undertaking to the State;
- (iii) The fact that the undertaking through which aid was granted had to take account of directives issued by governmental bodies;
- (iv) The integration of the public undertaking into the structures of the public administration;
- (v) The nature of the public undertaking’s activities and their impact on the market in normal conditions of competition with private operators;

⁸⁵⁹ Joined Cases 67/85, 68/85 and 70/85, *Kwekerij van der Kooy and Others v. Commission*.

⁸⁶⁰ Case 57/86, *Greece v. Commission*. It should be noted, however, that, even at that time, the Court had twice ruled out the existence of aid after establishing that the advantages concerned were not conferred directly or indirectly from State resources: see Case 82/77, *Van Tiggele* and Joined Cases 213/81 to 215/81, *Norddeutsches Vieh-und Fleischkontor Will and Others*.

⁸⁶¹ Joined Cases C-72/91 and C73/91, *Sloman Neptun*.

⁸⁶² Case C-482/99, *France v Commission (Stardust)*. However, these are often considered together when assessing a measure under Treaty, Art. 107(1), as they both relate to the public origin of the measure in question (State Aid Notice, para. 38).

⁸⁶³ Case C-189/91, *Kirsammer-Hack*; Case C200/97, *Ecotrade*; Case C295/97, *Piaggio*; see also Case C379/98, *PreussenElektra*, where the Court was openly invited by the Commission to reconsider its case law, particularly in light of the recent developments in the Community legal system, but did not take up that invitation. See Case C-677/11 *Doux Élevage and Coopérative agricole UKL-ARREE* and Case C-262/12, *Vent De Colère and Others*.

⁸⁶⁴ Case C-482/99, *France v. Commission (Stardust)*.

(vi) The legal status of the undertaking (whether it is subject to public law or ordinary company law), although the mere fact that a public undertaking has been constituted in the form of a capital company under ordinary law cannot be regarded as sufficient reason to exclude imputability, having regard to the autonomy that that legal form confers on it;

(vii) The degree of supervision that the public authorities exercise over the management of the undertaking; and

(viii) Any other indicator showing the involvement of the public authorities in adopting the measure in question or the unlikelihood of their not being involved, taking account of the scope of the measure, its contents or the conditions it contains.

While an advantage granted to one or more undertakings must be financed through State resources for it to be regarded as State aid within the meaning of Article 107(1) of the TFEU, it is not necessary to establish in every case that there has been a transfer of such resources.⁸⁶⁵

The fact that the State chooses not to collect revenue, even though this does not involve any direct transfer of public resources, may also constitute aid within the meaning of Article 107 of the TFEU.⁸⁶⁶

d. Case Law Indicators

Based on the jurisprudence of the CJEU, the following may satisfy the condition of being financed through State resources:

- (i) A tax exemption or tax relief⁸⁶⁷
- (ii) A deferral of tax, in some circumstances, taking the form of payment facilities granted in relation to the collection of employers’ and workers’ social security contributions to an undertaking on a discretionary basis by the body responsible for collecting such contributions;⁸⁶⁸
- (iii) A supply of goods or services on preferential terms;⁸⁶⁹ and
- (iv) A *de facto* waiver of public debts or an exemption from the obligation to pay fines and other pecuniary penalties.⁸⁷⁰

The State Aid Notice also specifies that, for the purposes of the State resources requirement, a positive transfer of funds is not necessary and that a foregoing of State revenues is sufficient.

Waiving revenue that would otherwise have been paid to the State constitutes a transfer of State resources (which is in line with the case law of the CJEU).⁸⁷¹

⁸⁶⁵ Case C-387/92, *Banco Exterior de España*; Case C-404/97, *Commission v. Portugal*; and Case C-6/12, *P Oy*.

⁸⁶⁶ Case C-387/92, *Banco Exterior de España*; Case C-6/97 *Italy v. Commission*.

⁸⁶⁷ See Case C-387/92, *Banco Exterior de España*; Case C-6/97, *Italy v. Commission*; and Case C-156/98, *Germany v. Commission*.

⁸⁶⁸ Case C-256/97, *DM Transport*.

⁸⁶⁹ Case C-39/94, *SFEI and Others*.

⁸⁷⁰ Case C-295/97, *Piaggio*.

⁸⁷¹ See, e.g., Case C-83/98, *France v. Ladbroke Racing and Commission*.

Example: A “shortfall” in tax and social security revenue due to the granting by a Member State of:

- (i) Exemptions or reductions in taxes or social security contributions; or
- (ii) Exemptions from the obligation to pay fines or other pecuniary penalties,

meets the State resources requirement of Article 107(1) of the TFEU.⁸⁷²

3. “Favoring Certain Undertakings or the Production of Certain Goods” — Selectivity

a. General

The main criterion, and the constituent factor,⁸⁷³ in applying Article 107(1) of the TFEU is that the (tax) measure must be specific or selective — Article 107(1) requires that the aid favor “certain undertakings or the production of certain goods.”

The CJEU has consistently defined “undertakings” as entities engaged in an economic activity, regardless of:

- (i) Their legal status; and
- (ii) The way in which they are financed.⁸⁷⁴

The status of the entity under national law is not decisive.⁸⁷⁵ Any activity that consists of offering goods and services on a market is an economic activity.⁸⁷⁶ Based on the case law of the CJEU (and the General Court):

- (i) Nonprofit entities can offer goods and services on a market too,⁸⁷⁷ where they do not do so, nonprofit providers remain outside State aid control.⁸⁷⁸
- (ii) An entity that carries on both economic and non-economic activities is to be regarded as an undertaking only with regard to the former.⁸⁷⁹

Several separate legal entities may be considered to form one economic unit for the purposes of the application of State aid rules. That economic unit is then considered to be the relevant undertaking. In this respect, the CJEU considers the existence of the following to be relevant:

- (i) A controlling share; and
- (ii) Other functional, economic and organic links.⁸⁸⁰

The simple fact that an entity holds shares, even a majority shareholding, in an undertaking providing goods or services on a market does not mean that that entity should automatically be considered an undertaking for the purposes of Article 107(1) of

the Treaty. Where that shareholding only gives rise to the exercise of rights attached to the status of shareholder as well as, if appropriate, the receipt of dividends, which are merely the fruits of the ownership of an asset, that entity will not be considered an undertaking if it does not itself provide goods or services on a market.⁸⁸¹

Article 107(1) of the Treaty does not apply where:

- (i) The State acts “by exercising public power;”⁸⁸² or
- (ii) Public entities act “in their capacity as public authorities.”⁸⁸³

An entity may be deemed to act by virtue of its exercising public power where the activity in question:

- (i) Forms part of the essential functions of the State; or
- (ii) Is connected with those functions by its nature, its aim and the rules to which it is subject.⁸⁸⁴

Generally speaking, unless the Member State concerned has decided to introduce market mechanisms, activities that intrinsically form part of the prerogatives of official authority and are performed by the State do not constitute economic activities. The State Aid Notice gives the following examples:

- (i) The army and the police;
- (ii) Air navigation safety and control;
- (iii) Maritime traffic control and safety;
- (iv) Anti-pollution surveillance;
- (v) The organization, financing and enforcement of prison sentences;
- (vi) The development and revitalization of public land by public authorities; and
- (vii) The collection of data to be used for public purposes based on a statutory obligation imposed on the undertakings concerned to disclose such data.⁸⁸⁵

Logically, advantages resulting from a general measure applicable without distinction to all economic operators do not constitute State aid within the meaning of Article 107(1) of the TFEU.⁸⁸⁶

• However, case law has made it clear that even interventions that, at first appearance, apply to undertakings in general may be selective to a certain extent and, accordingly, be regarded as measures designed to favor certain undertakings or the production of certain goods.⁸⁸⁷

• Neither a large number of eligible undertakings (which can even include all undertakings in a given sector), nor the diversity and size of the sectors to which they belong, provide grounds for concluding that a State measure con-

⁸⁷² State Aid Notice, para. 51.

⁸⁷³ Case C-88/03, *Portugal v. Commission*.

⁸⁷⁴ Joined Cases C-180/98 to C-184/98, *Pavlov and Others*. See also Case C-222/04, *Cassa di Risparmio di Firenze SpA and Others*.

⁸⁷⁵ State Aid Notice, para. 8.

⁸⁷⁶ Case 118/85, *Commission v. Italy*; Case C-35/96, *Commission v. Italy*; Joined Cases C-180/98 to C-184/98, *Pavlov and Others*.

⁸⁷⁷ Joined Cases 209/78 to 215/78 and 218/78, *Van Landewyck*; Case C-244/94, *FFSA and Others*; Case C-49/07, *MOTOE*.

⁸⁷⁸ State Aid Notice, para. 9.

⁸⁷⁹ State Aid Notice, para. 10.

⁸⁸⁰ Case C-480/09 P, *AceaElectrabel Produzione SpA v. Commission*; Case C-222/04, *Cassa di Risparmio di Firenze SpA and Others*.

⁸⁸¹ Case C-222/04, *Cassa di Risparmio di Firenze SpA and Others*.

⁸⁸² Case 118/85, *Commission v. Italy*.

⁸⁸³ Case 30/87, *Bodson*.

⁸⁸⁴ Case C-364/92, *SAT/Eurocontrol*; Case C-343/95, *Calì & Figli*.

⁸⁸⁵ State Aid Notice, para. 17.

⁸⁸⁶ Joined Cases C-106/09 P and C-107/09 P, *Commission and Spain v. Government of Gibraltar and United Kingdom* (paras. 72 and 73 and the case-law cited); see also Case C-66/02, *Italy v. Commission*; Case C-417/10, *3M Italia*; Case 6/12, *P Oy*. See also State Aid Notice, para. 118.

⁸⁸⁷ Case C-256/97, *DMTransport*.

stitutes a general measure of economic policy, if not all economic sectors can benefit from it.⁸⁸⁸

• The fact that the aid is not aimed at one or more specific recipients defined in advance, but that it is subject to a series of objective criteria according to which it may be granted, within the framework of a predetermined overall budget allocation, to an indefinite number of beneficiaries that are not initially individually identified, is insufficient to call into question the selective nature of the measure.⁸⁸⁹

For a tax measure to be general, it must be:

(i) Effectively open to all economic agents operating within a Member State on an equal access basis; and

(ii) May not *de facto* be reduced in scope through, for example, the discretionary power of the State to grant it or through other factors that restrict its practical effect.

However, this condition does not restrict the power of Member States to decide on the economic policy that they consider most appropriate and, in particular, to spread the tax burden as they see fit across the different factors of production. In this respect, it is worth emphasizing that the application of a general tax regime may result in different tax burdens for different operators and, therefore, differences in tax burdens are, as such, not sufficient to demonstrate the selective nature of an advantage.⁸⁹⁰

In addition, provided they apply without distinction to all firms and to the production of all goods:

(i) Tax measures of a purely technical nature, for example:

- (a) The setting of the rate of tax;
- (b) The depreciation rules;
- (c) The rules on loss carryovers; and
- (d) The provisions to prevent double taxation or tax avoidance; and

(ii) Measures pursuing general economic policy objectives through a reduction of the tax burden related to certain production costs, for example:

- (a) Research and development (R&D);
- (b) Environment;
- (c) Training; and
- (d) Employment

do not constitute State aid.

In the same vein, the fact that certain firms or sectors benefit from the tax measures more than others does not necessarily

mean that the measures are caught by the competition rules governing State aid.

• Thus, measures designed to reduce the taxation of labor for all firms have a relatively greater effect on labor-intensive industries than on capital-intensive industries, without necessarily constituting State aid.

• Similarly, tax incentives for environmental, R&D or training investment favor only the firms that undertake such investment, but do not necessarily constitute State aid.

Notwithstanding the foregoing, despite the fact that an analysis of the legal provisions of a particular tax measure may justify its qualification as a general tax measure, it is still possible that the application of that measure favors certain undertakings or certain products and is therefore selective, for example, where the administration called upon to apply the general rule has discretion when applying the measure.⁸⁹¹

b. Material Selectivity

Material selectivity, which is at the heart of State aid law in tax matters, can be established *de jure* or *de facto*.⁸⁹²

(i) *De jure* selectivity results directly from the legal criteria for granting a measure that is formally reserved only for certain undertakings

This includes, for example, the following:

- (1) Undertakings having a certain size;
- (2) Undertakings located in certain areas;
- (3) Undertakings active in certain sectors;
- (4) Undertakings having certain legal forms;⁸⁹³
- (5) Companies incorporated during particular periods;
- (6) Companies belonging to a group having certain characteristics; or
- (7) Companies entrusted with certain functions within a group.⁸⁹⁴

(ii) *De facto* selectivity can be established in cases where, although the formal criteria for the application of the measure are formulated in general and objective terms, the structure of the measure is such that its effects significantly favor a particular group of undertakings.⁸⁹⁵

⁸⁸⁸ Case C-75/97, *Belgium v. Commission*; Case C-143/99, *Adria-Wien Pipeline*.

⁸⁸⁹ State Aid Notice, para. 118, referring to the judgments of the General Court in T-55/99, *Confederación Española de Transporte de Mercancías v. Commission* and in T-379/09, *Italy v. Commission*. The measure in question in the latter case was a partial exemption from excise duty on the diesel used for heating greenhouses. The General Court indicated that the fact that the exemption could benefit all undertakings choosing greenhouse production was not sufficient to establish the general character of the measure.

⁸⁹⁰ Joined Cases C-106/09 P and C-107/09 P, *Commission and Spain v. Government of Gibraltar and United Kingdom*.

⁸⁹¹ Case C-214/94, *France v. Commission*; Case C-200/97, *Ecotrade*; Case C-295/97, *Piaggio*.

⁸⁹² State Aid Notice, paras. 121–122.

⁸⁹³ Joined Cases C-78/08 to C-80/08, *Paint Graphos and others*.

⁸⁹⁴ See, e.g., Joined Cases C-182/03 and C-217/03, *Belgium and Forum 187 v. Commission*.

⁸⁹⁵ See, e.g., Joined Cases C-106/09 P and C-107/09 P, *Commission and Spain v. Government of Gibraltar and United Kingdom*, concerning the Gibraltar tax reform. The reform introduced a system consisting of three taxes applicable to all Gibraltar companies, namely a payroll tax, a business property occupation tax (BPOT) and a registration fee. Liability for payroll tax and BPOT would have been capped at 15% of profits. The Court found that such a combination of taxes excluded from the outset any taxation of offshore companies since they had no taxable basis due to the lack of employees and the lack of business property in Gibraltar.

De facto selectivity may be the result of conditions or barriers imposed by Member States preventing certain undertakings from benefiting from the measure concerned.

Example: Applying a tax measure (e.g., a tax credit) only to investments exceeding a certain threshold (other than a minor threshold for reasons of administrative expediency) may mean that the measure is *de facto* reserved for undertakings with significant financial resources.⁸⁹⁶

Broadly, the decisive question in assessing the material selectivity of a tax measure is whether the tax measure at issue constitutes an exception to the general tax system.

Obviously, the crux of this exercise is the (prior) definition of the “general,” “normal” or “common” tax system as it is this system that serves as the referential framework for the purposes of determining whether the tax measure at issue derogates therefrom (see XVI.B.3.d., below).

c. Geographical (Regional) Selectivity

Geographical selectivity refers to the selectivity of (tax) measures that are regional or local in scope and deals with Member States’ devolutions of taxing powers and constitutional systems.

In Member States that have symmetrical decentralization, which constitutes a model for shared fiscal sovereignty (the “symmetrical devolution of taxing powers,”) a tax measure cannot be found to be geographically selective since, in such systems, powers are distributed uniformly, i.e., all entities are equally entitled to set up their own tax provisions. As such, there is no common (tax) reference system at the national level.

However, the fact that in such cases a tax measure cannot be found to be geographically selective does not, as such, prevent the measure from being materially selective in the sense explained in XVI.B.3.b., above.

In contrast, in Member States that have asymmetrical decentralization, a model in which there are infra-State bodies that enjoy autonomous powers, while the remainder of the territory of the Member State is subject to a general regime (the “asymmetrical devolution of taxing powers,”) the traditional view has been that the reference framework is the tax system that applies in the entire territory of the Member State, implying that a tax measure granted by a region that favors undertakings established in that region in comparison to undertakings established in the rest of the Member State is selective within the meaning of Article 107 of the TFEU. In other words, the exercise of financial autonomy by the region in question resulting from the asymmetrical devolution of taxing powers throughout the State can constitute State aid if it leads to tax rates in that region that are preferential in comparison to those imposed in the rest of that State.

In *Portugal v. Commission*,⁸⁹⁷ however, the CJEU observed that, in determining whether a regional or local measure is selective and consequently likely to constitute State aid, the reference framework to be examined was not necessarily that of the territory of the Member State concerned. Where a measure adopted by an infra-State entity established a lower tax

rate in part of the territory of a Member State, the framework might therefore be limited to the geographical area concerned where the entity, particularly by virtue of its status and powers, occupied a fundamental role in the definition of the political and economic environment in which the undertakings present in the territory under its competence operated. To determine the tax autonomy of the regional or local authority, the CJEU proposed a three-stage examination:

- (i) The measure should be adopted by a regional or local authority that has, from a constitutional point of view, a political and administrative status separate from that of the central government (institutional autonomy);
- (ii) The measure should be adopted without the central government having the ability to interfere in its substance (procedural autonomy); and
- (iii) The financial consequences of a reduction of the national tax rate for undertakings in the infra-State entity region must not be compensated for, or offset by, incentives, aid or subsidies from other regions or the central government (economic and financial autonomy).

In *UGT-Rioja*,⁸⁹⁸ after repeating that, in order to be adopted in the exercise of powers that are sufficiently autonomous, a decision of an infra-State authority must have been taken without the central government being able directly to intervene as regards its contents, the CJEU added that:

- (i) It was for the national court to determine the tax autonomy of the infra-State entity;
- (ii) Procedural autonomy did not rule out the establishment of a national conciliation procedure to avoid (legislative) conflicts, provided the final decision taken at the conclusion of that procedure was adopted by the infra-State body and not by the central government; and
- (iii) The mere fact that it appeared from a general examination of the financial relations between the central State and its infra-State bodies that there were financial transfers between the former and the latter, could not, in itself, suffice to demonstrate that those bodies did not assume the financial consequences of the tax measures that they adopted and, accordingly, that they did not enjoy financial autonomy, since such transfers might take place for reasons unconnected with the tax measures.

Some legal scholars have criticized the autonomy test on the grounds that it effectively amounts to an intrusion into the constitutional systems of the Member States.

d. Selectivity Test

(1) Three-Step Test

According to the CJEU, the selectivity of a tax measure should be assessed based on the “derogation test,” which involves a three-step process.

- (i) First, it is necessary to identify and examine the common or “normal” tax regime applicable in the Member

⁸⁹⁶ See, e.g., Case C-200/97, *Ecotrade*.

⁸⁹⁷ Case C-88/03, *Portugal v. Commission* (the “Azores” case).

⁸⁹⁸ Joined Cases C-428/06 to C-434/06, *UGT-Rioja*.

State concerned (i.e., the tax system of reference or referential framework).

(ii) Second, it is in relation to this common or “normal” tax regime that it is further necessary to assess and determine whether any advantage granted by the tax measure at issue may be selective by demonstrating that the measure derogates from that common regime inasmuch as it differentiates between economic operators that, in the light of the objective assigned to the tax system of the Member State concerned, are in a comparable factual and legal situation.⁸⁹⁹ In this respect, qualifying a tax measure as State aid requires a careful analysis of the “effects” of the tax measure at issue as, according to the CJEU, Article 107(1) of the TFEU does not distinguish between measures of State intervention by reference to their causes or aims, but defines them in relation to their effects and thus independently of the techniques used.⁹⁰⁰

(iii) Third, it should be assessed whether the measure, although conferring an advantage on its recipient, is justified by the nature or general scheme of the system in that it results directly from the basic or guiding principles of that tax system⁹⁰¹ (in which case it is considered not to fulfill the condition of selectivity).⁹⁰²

The State Aid Notice acknowledges that the three-step analysis cannot be applied in certain cases, taking into account the practical effects of the measures concerned, meaning that in certain exceptional cases it is not sufficient to examine whether a given measure derogates from the rules of the reference system as defined by the Member State concerned. In such cases, it is also necessary to evaluate whether the boundaries of the system of reference have been designed in a consistent manner or, conversely, in a clearly arbitrary or biased way, to favor certain undertakings that are in a comparable situation with regard to the underlying logic of the system in question.⁹⁰³

This is illustrated by the *Commission and Spain v Government of Gibraltar and United Kingdom* cases⁹⁰⁴ concerning the Gibraltar tax reform, where the CJEU found that the reference system, as defined by the Member State concerned, although founded on criteria that were of a general nature, discriminated in practice between companies that were in a comparable situation with regard to the objective of the tax reform, resulting in a selective advantage being conferred on offshore companies.

In this respect, the Court found that the fact that offshore companies were not taxed was not a random consequence of the regime, but the inevitable consequence of the fact that the bases of assessment were specifically designed so that offshore companies had no tax base.

⁸⁹⁹ See, e.g., Joined Cases C-78/08 to C-80/08, *Paint Graphos and Others*.

⁹⁰⁰ Case C-76/09 P, *Comitato Venezia vuole vivere*; *Commission*; see also Case C-279/08 P, *Commission v. Netherlands*; Joined Cases C-106/09 P and C-107/09 P, *Commission and Spain v. Government of Gibraltar and United Kingdom*; Case C-124/10 P, *Commission v. EDF*.

⁹⁰¹ Joined Cases C-78/08 to C80/08, *Paint Graphos and Others*.

⁹⁰² Case C-143/99, *Adria-Wien Pipeline and Wietersdorfer & Peggauer Zementwerke*.

⁹⁰³ State Aid Notice, para. 129.

⁹⁰⁴ Joined Cases C-106/09 P and C-107/09 P, *Commission and Spain v Government of Gibraltar and United Kingdom*.

The State Aid Notice adds that similar verification may also be necessary in certain cases concerning special-purpose levies, where there are elements indicating that the boundaries of the levy have been designed in a clearly arbitrary or biased way to favor certain products or certain activities that are in a comparable situation with regard to the underlying logic of the levies in question.⁹⁰⁵ An illustration of this may be found in *Ferring*,⁹⁰⁶ where the CJEU considered that a levy imposed on the direct sale of medicinal products by pharmaceutical laboratories but not on their sale by wholesalers was selective.

Considering the particular factual circumstances — such as the clear objective of the measure and its effect — the Court did not simply examine whether the measure in question would lead to a derogation from the reference system constituted by the levy. It also compared the situations of the pharmaceutical laboratories (subject to the levy) and the wholesalers (excluded), concluding that the non-imposition of the tax on the direct sales by the wholesalers equated to granting them a *prima facie* selective tax exemption.

(2) Identification of the Referential Framework

(a) General

The Achilles heel in the above-referenced process is without doubt the choice of the referential framework: the larger this is, the more a tax measure deviating from that framework is likely to be labeled as State aid, and *vice versa*.

Nonetheless, the *Adria-Wien Pipeline* case, where a tax measure applicable to undertakings carrying on activities in the production of goods was tested against a benchmark drawing a comparison between primary, secondary and tertiary sectors, is illustrative of the fact that the tendency of the CJEU (like that of the Commission) generally seems to be to opt for a rather large referential framework.⁹⁰⁷

In the case of taxes, the reference system is based on such elements as:

- (i) The tax base;
- (ii) The taxable persons;
- (iii) The taxable event; and
- (iv) The tax rates.

Example: A reference system could be identified with regard to:

- (i) The corporate income tax system;⁹⁰⁸
- (ii) The value added tax (VAT) system;⁹⁰⁹ or
- (iii) The general system of taxation of insurance.⁹¹⁰

The same applies to special-purpose (stand-alone) levies, such as levies on certain products or activities having a negative

⁹⁰⁵ State Aid Notice, para. 131.

⁹⁰⁶ Case C-53/00, *Ferring*.

⁹⁰⁷ *Ibid.*

⁹⁰⁸ Joined Cases C-78/08 to C80/08, *Paint Graphos and Others*.

⁹⁰⁹ Case C-172/03, *Heiser*.

⁹¹⁰ Case C-308/01, *GIL Insurance*.

impact on the environment or health, which do not really form part of a wider taxation system.

As a result, the reference system is, in principle, the levy itself.

(b) Case Law

In *World Duty Free Group*⁹¹¹ and *Commission v. Banco Santander and Santusa*,⁹¹² two of the cases⁹¹³ concerning a measure under Spanish tax law enabling (financial) goodwill attached to substantial shareholdings in foreign companies held by Spanish companies to be depreciated, the CJEU found that the General Court had failed properly to apply the second step. The decision of the General Court seemed to suggest that, in order to demonstrate selectivity, the Commission needed to identify a particular category of undertakings favored by the goodwill amortization scheme. In that analysis, the three-step process would have to be supplemented by a fourth step that would consist of identifying a particular category of undertakings exclusively favored by the measure at stake and could be distinguished by reason of specific features, common to them and characteristic of them.⁹¹⁴

The Grand Chamber⁹¹⁵ of the CJEU found that the General Court had wrongly inferred the existence of such a “supplementary requirement” from the case law, in particular, from *Commission and Spain v. Government of Gibraltar and United Kingdom*.⁹¹⁶ According to the CJEU, the appropriate criterion for establishing the selectivity of the measure at issue consisted of determining whether that measure introduced, between operators that were, in the light of the objective pursued by the general tax system concerned, in a comparable factual and legal situation, a distinction that was not justified by the nature and general structure of that system.

Therefore, the Court held that it was sufficient, in establishing the selectivity of a measure that derogated from an ordinary tax system, to demonstrate that that measure benefited certain operators and not others, although all those operators were in an objectively comparable situation in the light of the objective pursued by the ordinary tax system.

As a result, contrary to what was held by the General Court, it could not be required of the Commission, in order to establish the selectivity of such a measure, that it should identify certain specific features characteristic of, and common to, the undertakings that were the recipients of the tax advantage, by which they could be distinguished from those undertakings that were excluded from the advantage. Instead, all that matters in that regard was the fact that the measure, irrespective of its form or the legislative means used, should have the ef-

fect of placing the recipient undertakings in a position that was more favorable than that of other undertakings, although all those undertakings were in a comparable factual and legal situation in the light of the objective pursued by the tax system concerned.⁹¹⁷

Following referral back from the CJEU, on November 15, 2018, the General Court confirmed the Commission’s original assessment that the measure should be considered in the light of the general provisions of the corporate tax system, specifically the rules on the tax treatment of financial goodwill. Against this reference system, the General Court concluded that the measure could be selective even if it was available to all companies resident in Spain for tax purposes. The basis for the selectivity was the difference in treatment depending on the company’s commercial decision-making, i.e., acquiring a foreign company vs acquiring a domestic company.⁹¹⁸ This was a significant development because it confirmed that selectivity could be established based on the commercial behavior of undertakings.

(3) Selectivity of Tax Measures

(a) General

Under the selectivity test, a tax measure is selective if:

(i) It is intended partially to exempt certain undertakings from the financial charges arising from the normal application of the general system of compulsory contributions imposed by law;⁹¹⁹

(ii) It places certain undertakings in a more favorable situation than others;⁹²⁰

⁹¹⁷ Joined cases C-20/15 P and C-21/15, *World Duty Free Group*, paras. 60, 76, 78 and 79. The CJEU deems this position to be in line with its earlier rulings in Joined Cases 6/69 and 11/69, *Commission v. France*, Case 57/86, *Greece v. Commission* and Case C-501/00, *Spain v. Commission*, to which it explicitly refers.

⁹¹⁸ Case T-219 RENV, *World Duty Free Group v. Commission* and Case T-399/11 RENV, *Banco Santander and Santusa v. Commission*. See also the General Court’s judgments, all rendered on November 15, 2018 in (the other Spanish goodwill) Cases T-227/10, *Banco Santander v. Commission*, T-239/11, *Sigma Alimentos Exterior v. Commission*, T-405/11, *Axa Mediterranean v. Commission*, and T-406/11, *Prosegur Compañía de Seguridad v. Commission*. Spain (and other interested parties) appealed to the CJEU seeking to overturn these judgments — in a series of rulings delivered on October 6, 2021, the CJEU eventually upheld the recovery of the Spanish goodwill amortization (see Case C-50/19P, *Sigma Alimentos Exterior v. Commission*, Case C-51/19P, *World Duty Free Group v. Commission*, Case C-52/19P, *Banco Santander, SA v. Commission*, Case C-53/19P, *Banco Santander and Santuso v. Commission*, Case C-64/19P, *Spain v. Commission* and Case C-65/19P, *Spain v. Banco Santander and Santusa*). In 2012 the Spanish authorities introduced a new interpretation of the tax scheme according to which the goodwill amortization regime would apply in both direct and indirect acquisition cases. In an October 15, 2014 decision (the so-called “third decision”), the Commission concluded that the new interpretation was, in fact, new aid, incompatible with the internal market. On September 27, 2023, the General Court annulled the Commission decision (See Cases T-826/14, *Spain v. Commission*, T-12/15, *Banco Santander and Santusa v. Commission*, T-158/15, *Abertis Infraestructuras and Abertis Telecom Satélites v. Commission*, T-252/15, *Ferrovial and Others v. Commission*, T-253/15, *Sociedad General de Aguas de Barcelona v. Commission*, T-256/15, *Telefónica v. Commission*, T-257/15, *Arcelormittal Spain Holding v. Commission*, T-258/15, *Axa Mediterranean v. Commission* and T-260/15, *Iberdrola v. Commission*); the annulment was upheld by the CJEU in Joint Cases C-776/23 P -780/23 P, *Commission v Spain*.

⁹¹⁹ Case 173/73, *Italy v. Commission*.

⁹²⁰ Case C-241/94, *France v. Commission*.

⁹¹¹ Joined cases C-20/15 P and C-21/15, *World Duty Free Group*.

⁹¹² Joined cases C-20/15 P, *World Duty Free Group* and C-21/15 P, *Commission v. Banco Santander and Santusa*.

⁹¹³ These cases are commonly referred to as the “Spanish goodwill saga.”

⁹¹⁴ Case T-219/10, *Autogrill Española, SA v. Commission*, para. 41: “(...) the definition of a category of undertakings which are exclusively favored by the measure at issue is a prerequisite for recognizing the existence of State aid;” see, in the same vein, paras. 45, 67 and 68 of the judgment.

⁹¹⁵ The CJEU sits in a Grand Chamber of 13 judges when a Member State or an institution that is a party to the proceedings so requests, and in particularly complex or important cases.

⁹¹⁶ Joined cases C-106/09 P and C-107/09 P, *Commission and Spain v. Government of Gibraltar and United Kingdom*.

(iii) It places certain undertakings to which it applies in a more favorable situation than others, inasmuch as it allows them to continue trading in circumstances in which that would not be allowed if the usual insolvency rules were applied, since such rules are decisive when it comes to protecting creditors' interests;⁹²¹

(iv) It grants advantages accruing exclusively to certain undertakings or certain sectors;⁹²²

(v) It favors certain undertakings in comparison with other undertakings that are in a comparable legal and factual position in the light of the objective pursued by the measure in question;⁹²³

(vi) Within the context of a particular legal system, it constitutes an advantage for certain undertakings in comparison with others that are in a comparable legal and factual position;⁹²⁴

(vii) It gives rise to an advantage for certain undertakings as compared with others that, within the applicable legal framework, are in a comparable legal and factual position;⁹²⁵ or

(viii) Although it does not involve the transfer of State resources, it places the recipients in a more favorable financial position than other taxpayers.⁹²⁶

(b) State Aid Notice Guidance

The State Aid Notice emphasizes that the fact that a tax relief requires prior administrative authorization does not automatically mean that it constitutes a selective measure.⁹²⁷

(i) This is not the case where a prior administrative authorization is based on objective, non-discriminatory criteria that are known in advance, thus circumscribing the exercise of the public administrations' discretion.

(ii) In addition, such a prior administrative authorization scheme must be based on a procedural system that is easily accessible and capable of ensuring that:

(a) Requests for authorization will be dealt with objectively and impartially within a reasonable time; and

(b) Refusals to grant authorization will be capable of being challenged in judicial or quasi-judicial proceedings.⁹²⁸

The State Aid Notice further acknowledges that cooperative companies are not in a comparable legal or factual position

to commercial companies. Therefore, preferential tax treatment for cooperative companies may be permitted provided:

(i) They act in the economic interests of their members; and

(ii) Their relations with their members are not purely commercial but personal and individual, the members are actively involved in the running of the business and the members are entitled to an equitable distribution of the results of economic performance.⁹²⁹

If, however, the cooperative society under examination is found to be comparable to a commercial company, it should be included in the same reference framework as a commercial company and undergo the three-step analysis described above. The third step of that analysis requires an analysis of whether the tax regime in question is justified by the logic of the tax system.

A derogation for cooperative societies in the sense that they are not taxed themselves as cooperatives can be justified, for example, by the fact that they distribute all their profits to their members and that tax is subsequently levied on those individual members (see XVI.B.3.e., below).

In any event, the reduced taxation must be proportionate and not go beyond what is necessary. Moreover, appropriate control and monitoring procedures must be applied by the Member State concerned.

Similarly, as regards UCIs, the State Aid Notice makes it clear that tax measures aimed at ensuring tax neutrality for investments in collective investment funds or companies should not be viewed as selective where those measures do not have the effect of favoring certain UCIs or certain types of investments, but rather of reducing or eliminating double economic taxation in accordance with the overall principles inherent in the tax system in question.⁹³⁰

For these purposes, tax neutrality means that taxpayers are treated in the same way whether they invest in assets such as government securities and shares of joint-stock companies, directly or indirectly through investment funds. Accordingly, a tax regime for UCIs that respects the purpose of fiscal transparency at the level of the intermediary vehicle may be justified by the logic of the tax system in question, provided the prevention of double economic taxation constitutes a principle inherent in the tax system in question.

By contrast, preferential tax treatment limited to well-defined investment vehicles (that fulfill specific conditions)⁹³¹ to the detriment of other investment vehicles that are in a comparable legal and factual situation should be viewed as selective.

• The State Aid Notice adds, however, that tax neutrality does not mean that such investment vehicles should be entirely exempt from any tax or that the fund managers should be exempt from tax on the fees charged by them for managing the underlying assets being invested into by the funds.

⁹²¹ Case C-200/97, *Ecotrade*.

⁹²² Case C-75/95, *Belgium v. Commission*.

⁹²³ Case C-143/99, *Adria-Wien Pipeline*; Joined Cases C-106/09 P and C-107/09 P, *Commission and Spain v. Government of Gibraltar and United Kingdom*.

⁹²⁴ Joined Cases C-78/08 to C-80/08, *Paint Graphos and Others*.

⁹²⁵ Case C-88/03, *Portugal v. Commission*; Case C-172/03, *Wolfgang Heiser v. Finanzamt Innsbruck*; Case C-169/08, *Presidente del Consiglio dei Ministri v. Regione Sardegna*.

⁹²⁶ Joined Cases C-106/09 P and C-107/09 P, *Commission and Spain v. Government of Gibraltar and United Kingdom*; Case C-6/12, *P Oy*.

⁹²⁷ State Aid Notice, para. 125.

⁹²⁸ Case C-157/99, *Smits and Peerbooms*; Case C-203/08, *Sporting Exchange Ltd, trading 'Betfair' v. Minister van Justitie*.

⁹²⁹ State Aid Notice, para. 158; see also Joined Cases C-78/08 to C-80/08, *Paint Graphos and others*.

⁹³⁰ State Aid Notice, para. 162.

⁹³¹ The State Aid Notice, gives the example of preferential tax treatment at the investment vehicle level being conditional on the investment of three-quarters of the fund's assets in SMEs.

• It also does not justify the more beneficial tax treatment of a collective investment than the tax treatment of an individual investment for the tax regimes in question. In such a case, the tax regime would be disproportionate and would go beyond what is necessary to achieve the objective of preventing double taxation and would therefore constitute a selective measure.⁹³²

As regards tax amnesties, i.e.:

- (i) Immunity from criminal prosecution;
- (ii) Fines; and
- (iii) Interest,

the State Aid Notice makes it clear⁹³³ that a tax amnesty may be considered a “general measure” provided:

- (a) The measure is effectively open to any undertaking of any sector or size that has outstanding tax liabilities due at the date set by the measure, without favoring any pre-defined group of undertakings;
- (b) The measure does not entail any *de facto* selectivity in favor of certain undertakings or sectors;
- (c) The tax administration’s action is limited to administering the implementation of the tax amnesty without any discretionary power to intervene in the granting or intensity of the measure; and
- (d) The measure does not entail a waiver from verification.

While limited temporal application is inherent in the concept of a tax amnesty, the period of application should be sufficient to allow all taxpayers to which the measure applies to seek to benefit from it.⁹³⁴

Tax amnesty measures may also be considered to be general measures if they follow the national legislature’s objective of ensuring compliance with a general principle of law, such as the principle that a judgment must be given within a reasonable period of time.

Moreover, general depreciation and amortization rules (which are considered to be tax measures of a purely technical nature) are indicated in the State Aid Notice not to amount to State aid, although there are specific circumstances in which they may constitute aid.⁹³⁵

• Thus, depreciation incentives (such as a shorter term of depreciation, a more favorable depreciation method or early depreciation) for certain types of assets or undertakings that are not based on the guiding principles of the depreciation rules in question may give rise to the existence of State aid.

• In contrast, accelerated and early depreciation rules for leased assets may be seen as general measures if the lease contracts in question are really accessible to companies in all sectors and of all sizes.⁹³⁶

• However, if the tax authority has the discretionary power to set different depreciation periods or different valuation methods, firm by firm or sector by sector, there is obviously a presumption of selectivity.

• Likewise, prior authorization from a tax administration as a condition for applying a depreciation scheme involves selectivity if the authorization is not limited to the prior verification of the legal requirements.

With respect to flat tax regimes for specific activities, the State Aid Notice considers that such regimes are not selective if they are justified by the concern to avoid a disproportionate administrative burden on certain types of undertakings because of their small size or sector of activity (for example, the agricultural or fisheries sector). On average, such flat tax regimes do not have the effect of implying a lower tax burden for those undertakings as compared to other undertakings excluded from their scope and do not entail advantages for a subcategory of their beneficiaries.⁹³⁷

Anti-abuse rules may be justified as measures to prevent tax avoidance by taxpayers.⁹³⁸ However, if they are not applied to certain transactions or undertakings in a way that is inconsistent with their underlying logic, they must be held to infringe State aid law.⁹³⁹

Although excise duties are largely harmonized at EU level (which may affect the imputability criterion discussed in XVI.B.3.b., above), this does not automatically imply that any duty relief in these areas would fall outside the scope of the State aid rules. In fact, a reduced excise duty on a particular product can grant a selective advantage to the undertakings that use the product in question as an input or sell it on the market.⁹⁴⁰

(c) Illustration: The Spanish Tax Lease System Cases

In 2006, the EU Commission received a number of complaints concerning the application of the “Spanish Tax Lease System” (the “STL system”) to certain finance lease agreements insofar as the system allowed shipping companies to benefit from a 20% to 30% price reduction when purchasing ships built by Spanish shipyards.

According to the Commission, the objective of the STL system was to generate a tax advantage for the economic interest groupings (EIGs) and investors who purchased shares therein, who subsequently transferred part of those advantages to the shipping companies that purchased a new vessel.

In its decision of July 17, 2013,⁹⁴¹ the Commission found that certain tax measures forming part of the STL system, including:

⁹³⁶ See Commission Decision of 20 November 2012 on SA.34736 on the early depreciation of certain assets acquired through a financial leasing (OJ C 384, December 13, 2012, p. 1).

⁹³⁷ State Aid Notice, para. 182.

⁹³⁸ See Case C-308/01, *GIL Insurance Ltd and others*.

⁹³⁹ State Aid Notice, para. 183.

⁹⁴⁰ See, e.g., Commission Decision 1999/779/EC of February 3, 1999 on an Austrian aid granted in the form of an exemption from beverage tax for wine and other fermented beverages sold directly at the place of production to the consumer (OJ L 305, November 30, 1999, p. 27).

⁹⁴¹ Commission Decision 2014/200/EU of July 17, 2013 on the aid scheme SA.21233 C/11 (ex NN/11, ex CP 137/06) implemented by Spain — Tax scheme applicable to certain finance lease agreements also known as the Spanish Tax Lease System (OJ 2014 L 114, p. 1).

⁹³² State Aid Notice, para. 163.

⁹³³ State Aid Notice, paras. 166–168.

⁹³⁴ State Aid Notice, paras. 166–168.

⁹³⁵ State Aid Notice, paras. 177–180.

(i) The discretionary application of the early depreciation of leased assets; and

(ii) The STL system as a whole,

constituted State aid in the form of a selective tax advantage that was partly incompatible with the internal market.

On actions for annulment of the Commission's decision being brought by Spain and certain leasing operators, the General Court annulled the decision. In particular, the Court took into account the fact that the existence of a discretionary power conferred on the tax administration was not sufficient to render the advantages resulting from the STL system as a whole selective, as those advantages were available on the same terms to any investor that decided to take part in transactions under the STL system.⁹⁴²

In its judgment of July 25, 2018,⁹⁴³ the CJEU set aside the judgment of the General Court. In particular, the CJEU held that the General Court had erred in law in that it had based its analysis of the selective nature of the tax measures on the erroneous premise that investors and not EIGs were the beneficiaries of the tax benefits. Noting that the General Court had not ruled on all the pleas in law raised before it, the CJEU found that the state of the proceedings did not enable it to pronounce a final judgment and, accordingly, referred the case back to the General Court.

In its judgment of September 23, 2020, the General Court dismissed the actions brought by the appellants,⁹⁴⁴ who subsequently brought actions for annulment of that judgment before the CJEU, arguing (again) that the General Court had erred in law in the interpretation of Article 107(1) of the TFEU, concerning the selectivity of the measure.⁹⁴⁵

In his Opinion delivered on September 29, 2022, Advocate General Pritt Pikamäe took the view that the method used by the General Court to examine the selectivity of the STL system was correct.

- The granting of the tax benefits under the STL system was conditional on companies obtaining prior authorization for early depreciation, which was granted by the tax authorities under a wide discretionary power.

- That discretionary power, framed by vague and non-objective criteria, allowed the tax administration to determine the beneficiaries of early depreciation or the conditions for such depreciation, which made it possible to regard the selectivity criterion as satisfied.

However, as regards the method of calculating the incompatible aid, the Advocate General was of the opinion that the judgment of the General Court was vitiated by a failure to state reasons, as a result of which that judgment (and the Commission's decision) should be partially annulled.

In its judgment of February 2, 2023 — the final stage of this saga — the CJEU followed the Advocate General's

opinion and annulled the recovery order contained in the 2013 Commission's decision. According to the CJEU, the tax lease scheme was not intended to favor investors (which the decision identified as beneficiaries), but was instead designed to transfer tax advantages to other entities.

The Commission therefore erred in its decision by:

(i) Restricting the recovery order to the investors; and

(ii) Preventing the aid from being recovered from its actual recipients.⁹⁴⁶

e. Justification Based on Nature or General Scheme of Tax System

As indicated in XVI.B.3.d., above, under the third limb of the selectivity test, it is necessary to assess whether a measure, although conferring an advantage on its recipient, is justified by the nature or general scheme of the system. This justification is particularly relevant in the context of tax measures.

Justification based on the "nature," "logic" or "general scheme" of the tax system, creatively described as an "amorphous concept,"⁹⁴⁷ is a derogatory rule and, consequently, is of strict interpretation, allowing the Member States only a narrow margin for action.

The justification must be based on the intrinsic features of the tax system concerned, implying that the tax measure at issue must derive directly from the basic or guiding principles of that system (by reference to the mechanisms inherent in that system).⁹⁴⁸

A derogation for cooperative societies in the sense that they are not taxed themselves as cooperatives can, for example, be justified by the fact that they distribute all their profits to their members and that tax is subsequently levied on those individual members.⁹⁴⁹

The basis for a possible justification could be constituted, among others, by the following:

(i) The need to fight fraud or tax evasion;

(ii) The need to take into account specific accounting requirements;

(iii) The administrative manageability;

(iv) The principle of tax neutrality;

(v) The progressive nature of income tax and its redistributive purpose;

(vi) The need to avoid double taxation,⁹⁵⁰ or

⁹⁴⁶ Joined Cases C-649/20 P, C-658/20 P and C-662/20 P, *Spain v. Commission*.

⁹⁴⁷ See Advocate General Geelhoed in his opinion for Case C-88/03, *Portugal v. Commission*.

⁹⁴⁸ See, e.g., Joined Cases C-78/08 to C-80/08, *Paint Graphos and Others*.

⁹⁴⁹ State Aid Notice, para. 160.

⁹⁵⁰ See, e.g., Joined Cases C-78/08 to C-80/08, *Paint Graphos and others*, where the CJEU referred to the possibility of relying on the nature or general scheme of the national tax system as a justification for the fact that cooperative societies that distribute all their profits to their members are not taxed themselves as cooperatives, provided that tax is levied on the individual members.

⁹⁴² Joined Cases T-515/13 and T-719/13, *Spain v. Commission*.

⁹⁴³ Case C-128/16 P, *Commission v. Spain and Others*.

⁹⁴⁴ Cases T-515/13 RENV and T-719/13 RENV.

⁹⁴⁵ Joined Cases C-649/20 P, *Spain v Commission*, C-658/20 P, *Lico Leasing and Pequenños y Medianos Astilleros Sociedad de Reconversión v Commission* and C-662/20 P, *Caixabank and Others v Commission*.

(vii) The objective of optimizing the recovery of fiscal debts.⁹⁵¹

However, objectives unrelated or external to the tax measure, such as:

- (i) Environmental objectives;
- (ii) Social objectives; or
- (iii) Regional development objectives,

cannot be taken into account to justify its selective nature.⁹⁵²

The CJEU, for its part, appears to be extremely reluctant to accept justifications based on the nature or general scheme of the tax system.⁹⁵³

A justification based on the need to make undertakings more competitive is systematically rejected.

4. *Distortion of Competition and Effect on Trade Between Member States*

The fourth and final condition that must be fulfilled for State aid to fall within the prohibition in Article 107(1) of the TFEU is that it must be aid that:

- (i) Affects trade between Member States; and
- (ii) Distorts, or threatens to distort, competition.

These are two distinct and necessary elements of the notion of aid. In practice, however, these criteria are often treated jointly in the assessment of State aid as they are, as a rule, considered to be inextricably linked.

For these purposes, it is necessary not to establish that the aid has a real effect on trade between Member States and that competition is actually being distorted, but only to examine

whether the aid is liable to affect such trade and distort competition.⁹⁵⁴

In particular, when aid granted by a Member State strengthens the position of an undertaking compared with other undertakings competing in intra-Community trade, the latter must be regarded as affected by that aid.⁹⁵⁵ In that regard, the fact that an economic sector has been liberalized at the Community level may serve to determine that the aid has a real or potential effect on competition and affects trade between Member States.⁹⁵⁶

In addition, it is not necessary that the beneficiary undertaking itself be involved in intra-Community trade. Aid granted by a Member State to an undertaking may help to maintain or increase domestic activity, with the result that undertakings established in other Member States have less chance of penetrating the market of the Member State concerned.

Furthermore, the strengthening of an undertaking that, until that point, was not involved in intra-Community trade may place that undertaking in a position that enables it to penetrate the market of another Member State.⁹⁵⁷

Broadly, a (tax) measure that satisfies the other criteria for characterization as State aid is likely to be held to distort competition and affect trade between Member States.

C. *The Specific Case of Tax Rulings and Settlements*

1. *General*

According to the State Aid Notice, tax ruling or advance tax clearance practices (including in the field of transfer pricing) may result in prohibited State aid.

While the function of a tax ruling is to establish in advance the application of the ordinary tax system to a particular case, in view of its specific facts and circumstances, the grant of a tax ruling must, however, respect the State aid rules. Where a tax ruling endorses a result that does not reflect, in a reliable manner, what would result from a normal application of the ordinary tax system, that ruling may confer a selective advantage on the addressee, insofar as that selective treatment results in a lowering of that addressee's tax liability in the Member State as compared to companies in a similar factual and legal situation.

The State Aid Notice illustrates this with the example of a tax ruling that endorses a transfer pricing methodology for determining a corporate group entity's taxable profit that does not result in a reliable approximation of a market-based outcome in line with the arm's-length principle; such a ruling confers a selective advantage on its recipient.⁹⁵⁸

⁹⁵¹ State Aid Notice, para. 139. Examples of justifications set out in the 1998 Commission Notice on the application of the State aid rules to measures relating to direct business taxation (98/C 384/03) (which, however, was repealed by the State Aid Notice (see XVI.A., above)) included: (i) the economic rationale of a measure making the measure necessary to the functioning and effectiveness of the tax system; (ii) the progressive nature of an income tax scale or profit tax scale (because this may achieve the redistributive purpose of the tax system); (iii) the calculation of asset depreciation and stock valuation methods that are inherent in the tax systems to which they belong; (iv) (on the same basis) the possibility of arrangements for the collection of fiscal debts differing from one Member State to the other; (v) the exemption from taxes of "profits" of nonprofit-making undertakings, such as foundations or associations, if they cannot actually earn any profits; (vi) the non-imposition of tax at the level of cooperatives that distribute all their profits to their members when tax is imposed at the level of their members; (vii) specific provisions that do not contain discretionary elements, e.g., allowing tax to be determined on a fixed basis (for example, in the agricultural or fisheries sector) where, for example, such provisions take account of specific accounting requirements or the importance of land in assets that are specific to certain sectors; (viii) certain specific provisions on the taxation of SMEs (including small agricultural enterprises) having a logic comparable to that underlying the progressivity of a tax scale; or (ix) objective differences between taxpayers where there is a direct link between the alleged specific features and the tax concessions granted.

⁹⁵² See Joined Cases C-78/08 to C-80/08, *Paint Graphos and others*; Case C-88/03, *Portugal v. Commission*; Case C-279/08, *Commission v. Netherlands*; Case C-487/06, *British Aggregates v. Commission*; and Case C-6/12, *P Oy*.

⁹⁵³ See, e.g., Case C-143/99, *Adria-Wien Pipeline*; Case C-88/03, *Portugal v. Commission*; Case C-487/06, *British Aggregates v. Commission*; Joined Cases C-106/09 and C-107/09, *Commission and Spain v. Government of Gibraltar and United Kingdom*. One of the notable cases in which the justification was accepted was Case C-308/01, *GIL Insurance*; see also Case C-88/03, *Portugal v. Commission*, where the CJEU cited as a potential justification the purpose of redistribution and the criterion of ability to pay.

⁹⁵⁴ Case C-372/97, *Italy v. Commission*; Case C-66/02, *Italy v. Commission*; Case C-148/04, *Unicredito Italiano*.

⁹⁵⁵ Case C-222/04, *Cassa di Risparmio di Firenze and Others*.

⁹⁵⁶ Case C-409/00, *Spain v. Commission*.

⁹⁵⁷ Case C-66/02, *Italy v. Commission*; Case C-148/04, *Unicredito Italiano*.

⁹⁵⁸ See also the position reflected in the Working Paper on State Aid and Tax Rulings issued by the Directorate-General for Competition in 2016; see http://ec.europa.eu/competition/state_aid/legislation/working_paper_tax_rulings.pdf. The Working Paper points out that, while the Member States enjoy fiscal autonomy in the design of their direct taxation systems, any fiscal measure a Member State adopts must comply with the EU State aid rules, which bind the Member States and enjoy primacy over their domestic legislation. It then states that a fiscal measure that endorses a method for determining an inte-

In this respect, the State Aid Notice emphasizes that the arm's-length principle necessarily forms part of the Commission's assessment of tax measures granted to group companies under Article 107(1) of the Treaty, independently of whether, and in what form, a Member State has incorporated this principle into its national legal system. It is used to establish whether the taxable profit of a group company for corporate income tax purposes has been determined based on a methodology that produces a reliable approximation of a market-based outcome. A tax ruling endorsing such a methodology ensures that that company is not treated favorably under the ordinary rules of corporate taxation of profits in the Member State concerned as compared to standalone companies that are taxed on their accounting profit, which reflects prices determined on the market negotiated at arm's length.

The arm's-length principle the Commission applies in assessing transfer pricing rulings under the State aid rules is therefore an application of Article 107(1) of the Treaty, which prohibits unequal treatment in the taxation of undertakings in a similar factual and legal situation.⁹⁵⁹ This principle binds the Member States and the national tax rules are not excluded from its scope.⁹⁶⁰

In sum, according to the State Aid Notice, a tax ruling confers a selective advantage on its addressee, in particular, where:

- (i) The ruling misapplies national tax law, and this results in a lower amount of tax;
- (ii) The ruling is not available to undertakings in a similar legal and factual situation; or
- (iii) The administration applies a more "favorable" tax treatment compared with that applied to other taxpayers in a similar factual and legal situation.

This could, for instance, be the case where the tax authority accepts a transfer pricing arrangement that is not at arm's length because the methodology endorsed by the ruling concerned produces an outcome that departs from a reliable approximation of a market-based outcome.

The same applies if the ruling allows its addressee to use alternative, more indirect methods for calculating taxable profits, for example, through the use of fixed margins for a cost-

grated group company's taxable profit in a manner that does not result in a reliable approximation of a market-based outcome in line with the arm's-length principle can confer a selective advantage on its recipient.

⁹⁵⁹ When examining whether a transfer pricing ruling complies with the arm's-length principle inherent in Treaty, Art. 107(1), the Commission may have regard to the guidance provided by the Organisation for Economic Co-operation and Development (OECD), in particular the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. Those guidelines do not deal with matters of State aid *per se*, but they capture the international consensus on transfer pricing and provide useful guidance to tax administrations and multinational enterprises (MNEs) on how to ensure that a transfer pricing methodology produces an outcome in line with market conditions. Consequently, if a transfer pricing arrangement complies with the guidance provided by the OECD Transfer Pricing Guidelines, including the guidance on the choice of the most appropriate method and leading to a reliable approximation of a market based outcome, a tax ruling endorsing that arrangement is unlikely to give rise to State aid (see State Aid Notice, para. 173).

⁹⁶⁰ See also European Parliament resolution of July 6, 2016 on tax rulings and other measures similar in nature or effect (2016/2038(INI)) calling on the Commission to investigate all cases of illegal State aid brought to its attention in order to ensure equality before the law in the Union.

plus or resale-minus method for determining an appropriate transfer pricing, when more direct methods are available.

The foregoing also applies, in the case of tax settlements with respect to which the State Aid Notice states that, while the competence of Member States in this field cannot be disputed, State aid may be involved, in particular, where it appears that the amount of taxes due has been significantly reduced without clear justification (for example, the optimization of the recovery of debt) or in a disproportionate manner to the benefit of the taxpayer.⁹⁶¹

In this context, a transaction between the tax administration and a taxpayer may, in particular, entail a selective advantage where:

- (i) In making disproportionate concessions to a taxpayer, the administration appears to apply a more "favorable" discretionary tax treatment compared to that applied to other taxpayers in a similar factual and legal situation; or
- (ii) It appears that the settlement is contrary to the applicable tax provisions and has resulted in a lower amount of tax (this might be the case, for example, where established facts should have led to a different assessment of the tax based on the applicable provisions, but the amount of tax due has been unlawfully reduced).⁹⁶²

2. Tax Rulings: Commission Decisions and Judicial Review

a. Introduction

Since 2013, the Commission's Directorate-General for Competition ("DG Competition") has been carrying out an inquiry into tax ruling practices from the perspective of the EU State aid rules.

By the end of 2014, all Member States had been asked to provide information about their tax ruling practices and the legal framework underlying those practices, as well as lists of tax rulings issued in the years 2010 to 2012 (and, partly, 2013).

Based on this information, DG Competition requested specific tax rulings. Overall, DG Competition has reportedly reviewed more than 1,000 tax rulings (including approximately 600 tax rulings that appeared in the public domain in November 2014 (the "LuxLeaks")).⁹⁶³

At the date of writing, the Commission's final decisions have been published concerning:

- (i) Luxembourg (*Fiat* — decision dated October 21, 2015);⁹⁶⁴
- (ii) The Netherlands (*Starbucks* — decision dated October 21, 2015);⁹⁶⁵

⁹⁶¹ State Aid Notice, para. 175.

⁹⁶² State Aid Notice, para. 176; see, e.g., Commission Decision 2011/276/EU of May 26, 2010 on State aid C 76/03, *Umicore SA*.

⁹⁶³ DG Competition Working Paper on State Aid and Tax Rulings, June 3, 2017: http://ec.europa.eu/competition/state_aid/legislation/working_paper_tax_rulings.pdf.

⁹⁶⁴ Press release IP/15/5880; see also State aid Register, case number SA.38375.

⁹⁶⁵ Press release IP/15/5880; see also State aid Register, case number SA.38374.

(iii) Belgium (excess profit exemption — decision dated January 11, 2016);⁹⁶⁶

(iv) Ireland (*Apple* — decision dated August 30, 2016);⁹⁶⁷

(v) Luxembourg (*Amazon* — decision dated October 4, 2017);⁹⁶⁸

(vi) Luxembourg (*ENGIE* — decision dated June 20, 2018);⁹⁶⁹

(vii) Luxembourg (*McDonald's* — decision dated September 19, 2018);⁹⁷⁰ and

(viii) The U.K. (group financing exemption under the U.K. CFC rules — decision dated April 2, 2019).⁹⁷¹

The following sections discuss each of these cases in further detail and, to the extent applicable, analyze the reaction that they triggered within the judicial review process conducted by the EU General Court and the CJEU, respectively.

The discussion follows the chronology of the Commission decisions.

[Open formal Commission investigations are discussed in XVI.C.3., below.]

b. The Fiat Case

(1) Commission Decision of October 21, 2015



Source: https://ec.europa.eu/commission/presscorner/detail/en/IP_15_5880.

Commission Decision (EU) 2016/2326 of October 21, 2015 on State aid SA.38375 (2014/C ex 2014/NN) which Luxembourg granted to Fiat⁹⁷² concerned a 2012 advance pricing arrangement (APA) (hereinafter, the “2012 ruling”) given by the Luxembourg tax authorities to Fiat Finance and Trade

(FFT), a Luxembourg resident company that provided treasury services and financing to the Fiat Chrysler Group.

The 2012 ruling was issued on the basis of Article 164(3) of the Luxembourg Income Tax Code (LIR) and Circular LIR no.164/2 of January 28, 2010 (Circular), which, in the Commission’s view, established the “arm’s length principle” under Luxembourg tax law (the Commission expressly stated that “Section 2 of the Circular, in particular, contains a description of the arm’s length principle as set out in the OECD TP Guidelines and transposed into domestic law.”)

The 2012 ruling calculated the profit due to FFT by reference to the capital required by FFT to:

- (i) Bear its risks (“hypothetical regulatory capital”); and
- (ii) Perform its functions, including:
 - (a) Market funding and liquidity investments;
 - (b) Relations with financial market actors; and
 - (c) Financial coordination and consultancy services to the group companies.

According to the Commission, it was critical that:

- (i) First:
 - (a) Different rates of return were due in respect of the hypothetical regulatory capital;
 - (b) Capital for functions performed, i.e., the “risk remuneration” was calculated by multiplying FFT’s hypothetical regulatory capital (estimated by applying the Basel II framework by analogy) with a pre-tax expected return (estimated using the Capital Asset Pricing Model (“CAPM”));⁹⁷³ and
 - (c) The “functions remuneration” was calculated by multiplying what was designated as FFT’s capital used to perform the functions by the (estimated) market interest rate applied to short-term deposits;

(ii) No remuneration was due under the 2012 ruling in respect of FFT’s holdings in the non-European entities (Fiat Finance Canada (FFC) and Fiat Finance North America (FFNA)).

These combined issues led the Commission to the finding that, within the reference system retained by the Commission, i.e., the general Luxembourg corporate income tax system, the 2012 ruling did not produce a result (i.e., the computation of FFT’s tax base) in line with the Commission’s conception of the arm’s length principle and, therefore, that State aid had been granted.

As a subsidiary line of reasoning, the Commission held that the contested tax ruling also granted FFT a selective advan-

⁹⁶⁶ Press release IP/16/42; see also State aid Register, case number SA.37667.

⁹⁶⁷ Press release IP/16/2923; see also State aid Register, case number SA.38373.

⁹⁶⁸ Press release IP/17/3701; see also State aid Register, case number SA.38944.

⁹⁶⁹ Press release IP/18/4288; see also State aid Register, case number SA.44888.

⁹⁷⁰ Press release IP/18/5831; see also State aid Register, case number SA.38945.

⁹⁷¹ Press release IP/19/1948; see also State aid Register, case number SA.44896.

⁹⁷² https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv%3AOJ.L_2016.351.01.0001.01.ENG&toc=OJ%3AL%3A2016%3A351%3ATOC.

⁹⁷³ The Capital Asset Pricing Model (“CAPM”) is the product of a financial investment theory that reflects the relationship between risk and expected return. The model assumes a linear relationship. The CAPM formula for calculating expected return is: $ER_i = R_f + \beta_i * (E(R_m) - R_f)$, where: ER_i is the expected return of investment, R_f is the risk-free rate, β_i is the beta of the investment (i.e., a measurement of its volatility of returns relative to the entire market), $E(R_m)$ is the expected market return; and $E(R_m) - R_f$ is the market risk premium. The CAPM is used to forecast returns that can be obtained with risk-bearing asset classes. The linear relationship means that taking extra risk will on average lead to higher returns.

tage in the context of the more limited reference system composed of group companies applying transfer pricing principles governed by:

- (i) Article 164(3) L.I.R.; and
- (ii) The Circular.

In this respect, it is noteworthy that, in the decision's attempt to demonstrate the existence of a selective advantage, the Commission relied heavily on the CJEU's judgement in *Belgium and Forum 187 v. Commission ASBL*,⁹⁷⁴ in which, according to the Commission, the Court had accepted that "a tax measure which results in a group company charging transfer prices that do not reflect those which would be charged in conditions of free competition, that is prices negotiated by independent undertakings negotiating under comparable circumstances at arm's length, confers an advantage on that group company, in so far as it results in a reduction of its taxable base and thus its tax liability under the ordinary corporate income tax system."

In the Commission's reading, there was thus something as a *sui generis* EU law arm's length principle, which would imply that the arm's length standard is applicable irrespective of whether or not it has been expressly codified in national law, provided it can be seen that the national system of corporate taxation seeks to treat integrated companies in the same way as stand-alone companies for tax purposes.

Fiat and Luxembourg, on December 29 and 30, 2018, respectively, lodged appeals against the Commission Decision before the EU General Court.⁹⁷⁵

(2) Judgment of the EU General Court of September 24, 2019

On September 24, 2019, the EU General Court upheld the Commission's Decision that the 2012 ruling conferred a selective advantage within the meaning of Article 107(1) of the TFEU.⁹⁷⁶

In essence, the EU General Court's approach centered on the choice and the estimation of the profit-level indicator and, therefore, on the 2012 ruling's endorsement of:

- (i) The segmented "risk remuneration"/"functions remuneration" calculation; and
- (ii) The non-remuneration of the portion of FFT's equity designated as supporting FFT's financial investments in FFNA and FFC.

First, the Court concurred with the Commission in that, unlike the accounting equity used for FFT's financing activities, regulatory capital had no connection with the profits that an investor would claim from the company in which he or she invested.

⁹⁷⁴ Joined Cases C-182/03 and C-217, *Belgium and Forum 187 v. Commission ASBL*.

⁹⁷⁵ Ireland supported the appeal as intervening party, undoubtedly because of its position in the (then ongoing) Apple case (see XVI.C.2.e., below).

⁹⁷⁶ Joined Cases T-755/15, *Luxembourg v. Commission* and T-759, *Fiat Chrysler Finance Europe v. Commission*.

- Regulatory capital was not an appropriate indicator of the profits obtained by a bank or financial institution, but merely the implementation of a prudential obligation to which those institutions were subject.

- Hypothetical regulatory capital, determined by the application, by analogy, of the Basel II framework, could not, *a fortiori*, constitute an appropriate indicator for determining the remuneration in respect of the risk to which FFT's capital was exposed.

Second, referring to paragraph 1.42 of the OECD Guidelines, the Court stated that it was the assets associated with each activity, and not the capital, that might be isolated and related to specific risks or activities.

- Unlike operating assets, capital was fungible and exposed to risk irrespective of the activity thereby served.
- Hence, the segmentation of FFT's capital (as endorsed by the 2012 ruling) was not appropriate since it was based on an entirely artificial analysis of the use of FFT's equity.
- The EU General Court therefore agreed with the Commission that the segmentation of FFT's equity capital, to which different rates of return had been applied, did not approximate the arm's-length principle.

Third, as regards the equity used for the shareholdings in FFNA and FFC, the Court found, in line with the Commission's reasoning, that, insofar as capital was fungible, the share of that equity that corresponded to the amount of the shareholdings in FFNA and FFC (constituting almost 60% of FFT's total equity) could not be separated from the rest of FFT's equity and, thus, had to be taken into account for the purposes of the risk remuneration.

It is noteworthy that the Court's basic reasoning in *Fiat*, notably with regard to the following:

- (i) The arm's length principle as a tool for making an assessment under Article 107(1) of the TFEU;
- (ii) The (necessary) comparison with the "normal" taxation where national tax law does not make a distinction between integrated undertakings and standalone undertakings for the purposes of their liability to corporate income tax;
- (iii) Article 107(1) of the TFEU allowing the Commission to verify whether the price level of intragroup transactions, accepted by the national authorities for determining the tax base of an integrated undertaking, corresponds to a price level of a transaction which has been negotiated in market conditions; and

(iv) The adherence to the OECD Guidelines, is similar to that developed in the *Starbucks* judgment rendered on the same date (see XVI.C.2.c.(2)), below.

The EU General Court also endorsed the Commission's reliance on *Belgium and Forum 187 v. Commission*, from which it had derived the existence of a *sui generis* EU law arm's length standard (see above).

(3) *Judgement of the CJEU of December 8, 2022*

Following the appeals brought before the CJEU by, respectively:

- (i) Ireland (Case C-898/19P); and
- (ii) Fiat Chrysler Finance Europe and the Grand Duchy of Luxembourg (Case-C-885/19P)

against the EU General Court's judgment, in its decision rendered on December 8, 2022,⁹⁷⁷ the CJEU:

- (i) Set aside the EU General Court's judgment; and
- (ii) Annulled the contested Commission Decision.

The CJEU essentially upheld the Opinion issued on December 16, 2021 by Advocate General Pikamäe in the case brought forward by Ireland,⁹⁷⁸ according to which the EU General Court had erred in law in deciding that the arm's length principle was part of the "normal" Luxembourg tax rules without citing a specific provision of Luxembourg law in support of that conclusion.

The CJEU recalled that it was the EU Member State concerned that determined, "by exercising its own competence in the matter of direct taxation and with due regard for its fiscal autonomy, the characteristics [of] (...) the 'normal' tax regime."

According to the Court, a tax measure does or does not confer a selective advantage only by comparison with that normal tax regime. While "[i]t is true, as the parties all agree, that the national law applicable to companies in Luxembourg

is intended, as regards the taxation of integrated companies, to bring about a reliable approximation of the market price [, whereby] that objective corresponds, in general terms, to that of the arm's length principle, the fact remains that, in the absence of harmonization in EU law, the specific detailed rules for the application of that principle are defined by national law and must be taken into account in order to identify the reference framework for the purposes of determining the existence of a selective advantage."

In other words, the CJEU stressed the importance for the Commission to get the "normal tax system" benchmark right as it otherwise voids the entire analysis that follows. The Court concluded that only the Member State's national law should be considered to determine this relevant benchmark because doing otherwise would mean that "the autonomy of a Member State in the field of direct taxation [...] cannot be fully ensured."

Concerning the Commission Decision's reliance on *Belgium and Forum 187 v. Commission*, from which it derived the existence of a *sui generis* EU law arm's length standard, as subsequently endorsed by the EU General Court (see above), the CJEU held that that judgment did not support the position that the arm's length principle was applicable where national tax law was intended to tax integrated companies and stand-alone companies in the same way, irrespective of whether, and in what way, that principle had been incorporated into that law.

In that judgment, it was in the light of the tax provisions laid down in the relevant national law, namely Belgian law, which provided for a mechanism for taxing profits according to the OECD "cost-plus" method, that the Court concluded that it was appropriate to use the arm's length principle.

It could not therefore be inferred from that judgment that the Court intended to establish an autonomous arm's length principle that applied independently of the incorporation of that principle into national law for the purposes of examining tax measures in the context of the application of Article 107(1) TFEU.

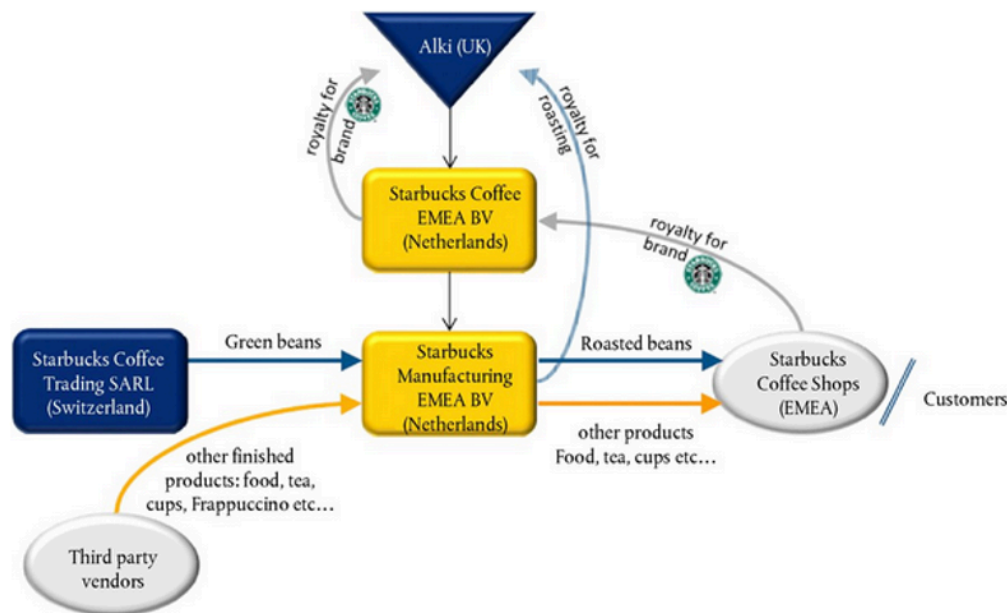
By Commission Decision of November 28, 2024 on tax ruling SA.38375 (2014/C) (ex 2014/NN) — Luxembourg, alleged aid to FFT (C (2024) 8564 final), addressed to Grand Duchy of Luxembourg, the Commission confirmed that "the contested tax ruling of 3 September 2012 of the Grand Duchy of Luxembourg in favor of FFT does not constitute State aid within the meaning of Article 107(1) of the TFEU".

⁹⁷⁷ Joined Cases C-885/19 P and C-898/19 P, *Fiat Chrysler Finance Europe and Ireland v. Commission*.

⁹⁷⁸ While the Advocate General, in his opinion in the appeal brought by Ireland, proposed the CJEU to set aside the General Court's judgment, in his — separate — opinion on the appeal brought by Fiat, he suggested the CJEU to dismiss the appeal in its entirety. The Advocate General considered, in particular, that in *Fiat* the General Court had correctly held that the Commission was not required to take account of the intra-group and cross-border dimension of the effects of the tax ruling at issue when determining whether that ruling conferred an economic advantage, and that the errors made, according to the Commission, in the calculation of the remuneration of the treasury and financing services provided by FFT prevented an arm's length outcome from being obtained and could therefore form the basis for a finding of economic advantage. By joining the cases, and by finding (based on the grounds of appeal submitted by Ireland) that the Commission had erred in law in defining the "normal tax system" benchmark (thus vitiating the entire analysis that followed), the CJEU did not rule on Fiat's appeal.

c. The Starbucks Case

(1) Commission Decision of October 21, 2015



Source: https://ec.europa.eu/commission/presscorner/detail/en/IP_15_5880.

Commission Decision (EU) 2017/502 of October 21, 2015 on State aid SA.38374 (2014/C ex 2014/NN) implemented by the Netherlands to Starbucks⁹⁷⁹ concerned an Advance Pricing Agreement (APA) granted in 2008 by the Netherlands to Starbucks Manufacturing EMEA BV (hereinafter SMBV), a Dutch subsidiary of the Starbucks corporation (US), which was indirectly controlled through a subsidiary, Alki, a tax resident of the United Kingdom.

SMBV was effectively a manufacturer, purchasing beans, roasting coffee and distributing it alongside related products to Starbucks shops in Europe, the Middle East and Africa. It concluded a roasting agreement with Alki by which it obtained the right to the use of the intellectual property required for the roasting and distribution of the coffee, in exchange for the payment of royalties.

Under the ruling, valid for 10 years, the tax base of SMBV was determined based on the transactional net margin method (TNMM),⁹⁸⁰ by reference to a certain percentage of the operating costs, excluding:

- (i) The costs of Starbucks cups, paper napkins, etc.;
- (ii) The costs of green coffee beans; and
- (iii) The logistics and distribution costs relating to:
 - (a) The services provided by third parties; and

- (b) The remuneration for activities provided by third parties under consignment manufacturing contracts, and the royalty payment.

As regards the royalty that SMBV had to pay annually to Alki, the APA provided that it was fixed on the basis of the difference between SMBV's operational profit made in respect of the production and distribution function, before royalty expenses, and SMBV's remuneration.

The royalty payment was deductible for corporate income tax purposes and was not subject to Dutch withholding tax.

In the Commission's view, the APA deviated from the reference system, i.e., the general corporate tax system of the Netherlands that had the objective of taxing all companies subject to tax in the Netherlands, as it resulted in an integrated company charging prices that did not reflect those which would have been charged in conditions of free competition, i.e., prices negotiated by independent undertakings negotiated under comparable circumstances at arm's length conditions. The APA therefore conferred an advantage on SMBV as it led to a reduction of its tax base and, consequently, of its tax liability under the Dutch ordinary corporate income tax system.

According to the Commission, thereby referring to the CJEU judgment in *Belgium and Forum 187 v. Commission*,⁹⁸¹ the APA's determination of SMBV's taxable profits in the Netherlands thus departed from a methodology that would result in a reliable approximation of a market-based outcome and, therefore, from the arm's length principle.

Consequently, the Commission found that the arm's length principle necessarily formed an integral part of its assessment, under Article 107(1) of the TFEU, of the tax measures granted to integrated companies, independently of whether a Member

⁹⁷⁹ <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32017D0502>.

⁹⁸⁰ Note that while the ruling referred to the method as "cost-plus," the APA actually applied and relied on TNMM.

⁹⁸¹ Joined Cases C-182/03 and C-217/03, *Belgium and Forum 187 v. Commission* (see also XVI.C.2.b.(1), above).

State had incorporated that principle into its national legal system (thereby relaunching the concept of a *sui generis* EU law arm's length standard introduced in the *Fiat* case, see XVI.C.2.b.(1), above).

As regards the royalty, the Commission considered the computation methodology accepted by the APA (also) not to be in line with the arm's length principle and leading to a reduction in SMBV's tax burden.

Following this reasoning, the Commission concluded that there was prohibited State aid, thereby identifying SMBV and the Starbucks group as a whole as aid beneficiaries, on the ground that they formed a single economic entity.

The Netherlands (Case T-760/15), and Starbucks Corp. and Starbucks Manufacturing Emea BV (Case T-636/16), supported by Ireland as intervener,⁹⁸² appealed the Commission Decision before the EU General Court on December 23, 2015 and September 5, 2016, respectively.

(2) *Judgment of the EU General Court of September 24, 2019*

On September 24, 2019, the EU General Court rendered its judgment in the *Starbucks* case.⁹⁸³

According to the Court, the Commission had not managed, by any of the lines of reasoning set out in the contested Commission Decision, to demonstrate to a requisite legal standard the existence of an advantage within the meaning of Article 107(1) of the TFEU. Accordingly, the contested Commission Decision was annulled in its entirety.

The EU General Court commenced by recalling that, according to settled caselaw, while direct taxation fell within the competence of the Member States, they had to nonetheless exercise that competence consistently with EU law. Thus, intervention by the Member States in matters of direct taxation, even if it related to issues that had not been harmonized in the European Union, was not excluded from the scope of the rules on the monitoring of State aid.

The EU General Court further stated that where national tax law did not make a distinction between integrated undertakings and standalone undertakings for the purposes of their liability to corporate income tax, that law was intended to tax the profit arising from the economic activity of such an integrated undertaking as if it had arisen from transactions carried out at market prices.

Therefore, when examining, pursuant to the power conferred on it by Article 107(1) of the TFEU, a fiscal measure granted to an integrated company, the Commission might compare the fiscal burden of such an integrated undertaking resulting from the application of the relevant fiscal measure with the fiscal burden resulting from the application of the normal rules of taxation under national law of an undertaking, placed

in a comparable factual situation, carrying on its activities under market conditions.

In this respect, there was a need to compare a regime of derogating aid with the ordinary tax system, based on the difference between profits and outgoings of an undertaking carrying on its activities in conditions of free competition. Thus, the arm's length principle was held to be a tool for making an assessment under Article 107(1) of the TFEU, i.e., a "benchmark" for establishing whether an integrated company was receiving, pursuant to a tax measure determining its transfer pricing, an advantage within the meaning of Article 107(1) of the TFEU.

However, when using that tool, the Commission could identify an advantage within the meaning of Article 107(1) of the TFEU only if the variation between the two comparables went beyond the inaccuracies inherent in the methodology used to obtain that approximation.

In the Court's eyes, despite the fact that the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (the "OECD Guidelines")⁹⁸⁴ did not constitute a legally binding instrument, those guidelines:

- (i) Were nevertheless based on important work carried out by groups of renowned experts; and
- (ii) Reflected the international consensus achieved with regard to transfer pricing.

As such, they had a real practical significance in the interpretation of issues relating to transfer pricing. The Court thus appeared to adhere to the OECD Guidelines.

The Court subsequently held that the Commission did not have, at that stage of the development of EU law, competence to allow it to define in an autonomous manner the "normal" taxation of an integrated undertaking, by disregarding national tax rules.

However, although "normal" taxation was defined by national tax rules and although the very existence of an advantage had to be established by reference to them, if those national rules provided that standalone companies and integrated companies had to be dealt with under the same conditions, Article 107(1) of the TFEU allowed the Commission to verify whether the price level of intragroup transactions, accepted by the national authorities for determining the tax base of an integrated undertaking, corresponded to a price level of a transaction which had been negotiated under market conditions.

Consequently, when the Commission examined whether the method validated in a national tax measure led to an outcome established in conformity with the arm's length principle, it did not exceed its competency. The EU General Court thereby endorsed the Commission's reliance on *Belgium and Forum 187 v. Commission*, from which it had derived the existence of a *sui generis* EU law arm's length standard (as it did in the *Fiat* case, see XVI.C.2.b.(2), above).

⁹⁸² Ireland undoubtedly intervened because of its position in the (then) ongoing Apple case (see XVI.C.2.e., below).

⁹⁸³ Joined Cases T-760/15, *Netherlands v. Commission* and T-636/16, *Starbucks and Starbucks Manufacturing Emea v Commission*.

⁹⁸⁴ Adopted by the OECD's Committee on Fiscal Affairs on June 27, 1995, and subsequently updated on July 22, 2010.

In any event, however, the examination of the existence of an advantage conferred by a tax ruling, such as the APA at hand, should have been determined in view of the context of the time at which that ruling was issued. Hence, the Court held that the Commission was required to refrain from assessments based on a situation subsequent to the adoption of the APA.

The Court further found that the Commission had failed to invoke any element to support the conclusion that the choice of the TNMM (and not of the CUP method) had necessarily led to a result that was too low, without a comparison being carried out with the result that would have been obtained using the CUP method. The Commission therefore wrongly found that the mere choice of the TNMM, in the present case, conferred an advantage on the Dutch Starbucks subsidiary.

As regards the royalty that SMBV paid for the use of Starbucks' coffee roasting intellectual property, the Court held that the mere finding by the Commission that the APA did not analyze the royalty did not suffice to demonstrate that the royalty was not actually in conformity with the arm's length principle. In addition, in the Court's view, the Commission failed to demonstrate that the level of the royalty should have been zero or that it resulted in a (selective) advantage within the meaning of Article 107(1) of the TFEU.

Lastly, the Court examined the dispute as to the Commission's subsidiary reasoning whereby the APA allegedly conferred an advantage on SMBV because the detailed rules for the application of the TNMM, as endorsed by the APA, were erroneous.

The CJEU found that the Commission did not demonstrate that the various errors it identified in the detailed rules for the application of the TNMM conferred an advantage on SMBV, as regards any of the following:

- (i) The validation by the APA of the identification of SMBV as the tested entity for the purposes of the application of the TNMM;
- (ii) The choice of profit level indicator or the working capital adjustment; and
- (iii) The exclusion of the costs of the unaffiliated manufacturing company.

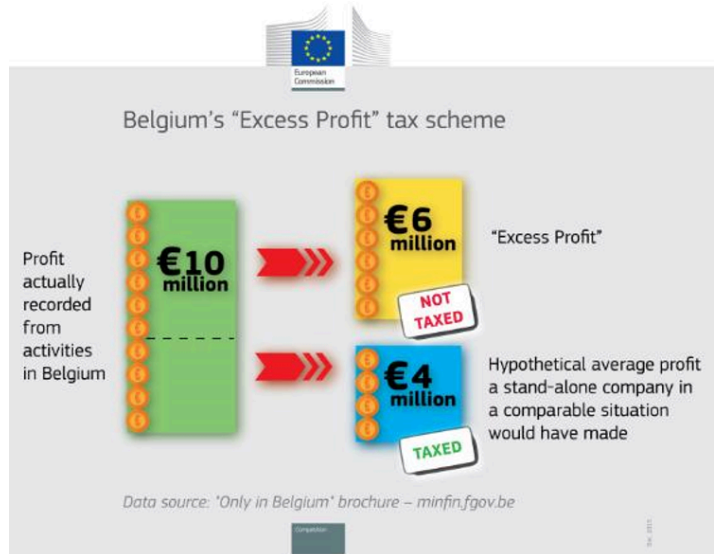
Consequently, according to the Court, the Commission failed to demonstrate the existence of an economic advantage within the meaning of Article 107(1) of the TFEU.

Against this backdrop, as indicated above, the EU General Court annulled the contested Commission Decision in its entirety.

The Commission did not appeal the EU General Court's judgment. By Commission Decision of November 28, 2024 on tax rulings SA.38374 (2014/C) (ex 2014/NN) (ex 2014/CP) — Netherlands, alleged aid to Starbucks (C (2024) 8566 final), addressed to the Kingdom of the Netherlands, the Commission confirmed that "with the contested advance pricing agreement issued by the tax administration of the Kingdom of the Netherlands on April 28, 2008, the Kingdom of the Netherlands did not confer aid within the meaning of Article 107(1) of the TFEU to Starbucks Manufacturing EMEA BV".

d. The Belgium Excess Profit Exemption Case

(1) Commission decision of January 11, 2016



Source: https://ec.europa.eu/commission/presscorner/detail/en/IP_16_42.

Commission Decision (EU) 2016/1699 of January 11, 2016 on the excess profit exemption State aid scheme SA.37667 (2015/C) (ex 2015/NN) implemented by Belgium⁹⁸⁵ concerned a Belgian tax provision that allowed group companies to reduce their corporation tax liability in Belgium substantially based on "excess profit tax rulings."

The Commission found these rulings to be illegal under the EU State aid rules, affecting 36 multinational enterprises (MNEs) that had benefited from the system.

In essence, the rulings allowed MNEs in Belgium to reduce their corporate tax liability by "excess profits" that were deemed to result from the fact that those MNEs formed part of a multinational group. In other words, the rulings assumed that an MNE generated levels of profit that a hypothetical stand-alone company in a comparable situation would not have made.

The Commission held this to infringe the EU State aid rules given that:

- (i) The rulings deviated from normal Belgian corporate tax practice by enabling the beneficiary MNEs to enjoy, in effect, a preferential selective subsidy compared with their competitors, which were liable to pay taxes in accordance with regular Belgian company tax treatment.
- (ii) Even assuming that MNEs did generate what might be termed "excess profit," this ought in any event to have been distributed across a corporate group in a manner reflective of "economic reality," in line with the arm's-length principle of allocating profits between group companies on market terms. Instead, under Belgium's scheme, in the Commission's view, alleged "excess profit" was simply discounted unilaterally from the tax base of a single group company.

⁹⁸⁵ https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv%3AOJ.L_2016.260.01.0061.01.ENG.

(iii) The scheme could not be justified by the need to prevent double taxation, i.e., rather than preventing double taxation, the scheme actually enabled double non-taxation.

Belgium (Case T-131/16) and Magnetrol International (Case T-263/16), as well as many of the 36 targeted companies, including:

- (i) AB InBev (Case T-370/16);
- (ii) Celio International (Case T-832/16);
- (iii) Cinema Group Kinopolis (Case T-350/16);
- (iv) Wabco Europe (Case T-637/16);
- (v) Atlas Copco (Case T-278/16); and
- (vi) BASF (Case T-319/16)

appealed the Commission Decision before the EU General Court in March 2016.

(2) *Judgment of the EU General Court of February 14, 2019*

On February 14, 2019, the EU General Court delivered its judgment in the Belgian excess profit rulings case.⁹⁸⁶

In its action brought before the EU General Court seeking the annulment of the contested Commission Decision, Belgium had alleged that the Commission:

- (i) Encroached upon Belgium's exclusive tax jurisdiction in the field of direct taxation; and
- (ii) Erred in finding an aid scheme in the case in question.

As regards the alleged encroachment upon Belgium's exclusive jurisdiction, the EU General Court noted that, while direct taxation fell within the competence of the Member States, they had to nonetheless exercise that competence consistently with EU law. Accordingly, a measure by which the public authorities granted certain undertakings advantageous tax treatment which — although it did not involve the transfer of State resources — placed the beneficiaries in a more favorable position than other taxpayers, was capable of constituting State aid. Since the Commission was competent to ensure compliance with the State aid rules, it could not be accused of having exceeded its powers in the case. The EU General Court thus rejected the encroachment argument.

As regards the existence of an aid scheme, the EU General Court found that the Commission erroneously considered that the excess profit exemption system constituted an aid scheme within the meaning of Article 1(d) of Council Regulation (EU) 2015/1589 of July 13, 2015, laying down detailed rules for the application of Article 108 of the TFEU (see XVI.F., below.)

- (i) First, the provisions identified by the Commission as the basis of the alleged aid scheme did not set out all the essential elements of that scheme. Accordingly, the implementation of those provisions and, thus, the grant of the alleged aid necessarily depended on the adoption of further implementing measures (such as the issuance of a ruling,) which, in the Court's opinion, precluded the existence of an aid scheme.

(ii) Second, the EU General Court found that the Belgian tax authorities had a margin of discretion over all of the essential elements of the exemption system in question, allowing them to influence:

- (a) The amount;
- (b) The characteristics of the exemption; and
- (c) The conditions under which the aid was granted,

which also precluded the existence of an aid scheme.

(iii) Third, the EU General Court held that it could not be concluded that the beneficiaries of the alleged aid scheme were defined in a general and abstract manner or that there was actually a systematic approach on the part of the Belgian tax authorities as regards all of the advance rulings concerned.

The EU General Court did not examine the other grounds of appeal and therefore did not consider the Commission's theory of selectivity specifically developed for tax rulings. The judgment also had limited (predictive) value for the other (pending) tax ruling cases that did not concern aid schemes but individual aid.

The Commission lodged an appeal before the CJEU against the judgment of the EU General Court.

In parallel, on September 16, 2019, the Commission launched an investigation "2.0" targeting the same arrangements, whereby the compatibility of such arrangements with the EU State aid rules was assessed individually (i.e., ruling by ruling) rather than as part of an aid scheme.

(3) *Judgment of the CJEU of September 16, 2021*

On September 16, 2021, the CJEU set aside the judgment of the EU General Court, essentially, on the basis that the EU General Court had misapplied the concept of "aid scheme."⁹⁸⁷

In the CJEU's opinion, the phrase "aid scheme" could also refer to a consistent administrative practice of the competent national authorities where that practice revealed a systematic approach.⁹⁸⁸ Although the EU General Court found that the legal basis of the scheme at issue resulted not only from a provision of the Belgian Income Tax Code, but also from the application of that provision by the Belgian tax authorities, it had not, however, drawn all the appropriate conclusions from that finding.

In particular, the EU General Court did not take account of the fact that the Commission inferred the application of that provision not only from certain acts, but also from a systematic approach on the part of those authorities.

⁹⁸⁷ Case C-337/19 P, *Commission v. Belgium and Magnetrol International*.

⁹⁸⁸ The CJEU thereby followed the Opinion of Advocate General Kokott — for the Advocate General, the Commission was perfectly allowed to examine a sample to establish the existence of an aid scheme, to the extent that such a sample is sufficiently representative. In *casu*, the E.U. Commission examined (i) one-third of the advance tax rulings (22 out of the 66), (ii) all issued by the Belgian Ruling Commission, (iii) all including profit adjustments in favor of corporate taxpayers that were part of a multinational group, and (iv) during different years (2004, 2007, 2010 and 2013). Hence, according to the Advocate General, the EU General Court erred in law by wrongly classifying the sample as not sufficiently representative to the requisite legal standard and not sufficient to demonstrate a "consistent administrative practice."

⁹⁸⁶ Joined Cases T-131/16, *Belgium v. Commission* and T-263/16, *Magnetrol International v. Commission*.

The EU General Court did, however, rely on the incorrect premise that the fact that certain key facts of the scheme at issue were not apparent from those acts, but from the rulings themselves, meant that those acts necessarily had to be the subject of further implementing measures. Consequently, by limiting its analysis to only the abovementioned normative acts, the EU General Court misapplied the term “act.”

As regards the second condition for defining an “aid scheme,” namely that no “further implementing measures” were required, the CJEU noted that that issue was intrinsically linked to the determination of the “act” on which that scheme was based. In the context of that examination, the EU General Court failed to take account of the fact that one of the essential characteristics of the scheme at issue was the fact that the Belgian tax authorities had systematically granted the excess profit exemption when the conditions were satisfied. Contrary to what the EU General Court held, the identification of such a systematic practice was capable of constituting a relevant factor to establish, where applicable, that the tax authorities did not in fact have any discretion.

As regards the third condition defining an “aid scheme,” namely that the beneficiaries of the excess profit exemption were defined “in a general and abstract manner,” the CJEU noted that that issue was also intrinsically linked to the first two conditions, relating to the existence of an “act” and the absence of “further implementing measures.”

Accordingly, the errors of law made by the EU General Court concerning the first two conditions vitiated its assessment of the definition of the beneficiaries of the excess profit exemption.

The CJEU therefore set aside the EU General Court’s judgment.

However, since the EU General Court in its 2019 judgment had not taken a position on whether the “excess profit” tax exemptions gave rise to illegal State aid (i.e., the EU General Court annulled the Commission’s decision only for failing to prove the existence of an aid scheme,) the CJEU referred the case back to the EU General Court to assess whether the tax exemption regime provided a selective advantage to the companies that applied for a ruling.

As a consequence of the CJEU’s confirmation of an aid scheme, the Commission was no longer required to continue the 39 separate in-depth investigations into individual rulings (the aforementioned investigation “2.0”) opened by the Commission following the (initial) EU General Court’s judgment.

(4) (Second) Judgment of the EU General Court of September 20, 2023

Upon a substantive second-time examination of the case, and contrary to its 2019 decision on excess profit rulings as a “scheme,” the EU General Court (Second Chamber, extended composition), in its judgment of September 20, 2023, held the Belgian excess profit exemption to be a scheme that constituted illegal State aid, thereby endorsing the 2016 Commission Decision.⁹⁸⁹

⁹⁸⁹ Case T-131/16 RENV, *Kingdom of Belgium v. European Commission*. On the same date, the EU General Court also dismissed the 29 actions brought against the European Commission’s decision by Soudal, Magnetrol International, Puratos and Others, Capsugel Belgium, Atlas Copco, Siemens Industry

The EU General Court first emphasized that it was settled case law that the definition of “aid” was more general than that of a subsidy, given that it included not only positive benefits, such as subsidies themselves, but also State measures which, in various forms, mitigated the charges which were normally included in the budget of an undertaking and which thus, without being subsidies in the strict sense of the term, were similar in character and had the same effect as them.

Accordingly, a measure through which the public authorities granted favorable tax treatment to certain undertakings, which, although not involving the transfer of State resources, placed the recipients in a more favorable financial position than other taxpayers, amounted to State aid within the meaning of Article 107(1) of the TFEU.

The Court further recalled that the existence of an economic advantage for the purposes of Article 107(1) of the TFEU might be established only when compared with “normal” taxation, i.e., the reference system, and that only the national law applicable in the Member State concerned had to be taken into account to identify that reference system, such identification constituting an essential prerequisite for assessing not only the existence of an advantage, but also whether it was selective in nature.

The EU General Court held that the Commission was right to find that the excess profit exemption applied by the Belgian tax authorities under the scheme at issue did not form part of the reference system (correctly) identified by the Commission, i.e., the ordinary Belgian corporate income tax system, but, rather, constituted a derogation from that reference system.

The EU General Court subsequently examined whether that derogation could be justified on the grounds that it resulted directly from the basic or guiding principles of the reference system. According to the Court, such examination required it to make a distinction between, on the one hand, the objectives attributed to a particular tax regime extrinsic to it and, on the other hand, the mechanisms inherent in the tax system itself that were necessary for the achievement of such objectives. Tax exemptions, which were the result of an objective that was unrelated to the tax system of which they formed part could not circumvent the requirements under Article 107(1) of the TFEU.

In conclusion, the EU General Court ruled that the Commission had not made an error of law or a manifest error of assessment in the contested Commission Decision when it held that:

- (i) The scheme at issue was financed through State resources;
- (ii) The reference system was the ordinary system of taxation of corporate profits, and it did not cover the excess profit exemption applied by the Belgian tax authorities;

Software, BASF Antwerpen, Ansell Healthcare Europe, VF Europe, Esko-Graphics, Trane, Kinopolis Group, Belgacom International Carrier Services, Punch Powertrain, Zoetis Belgium, Luciad, Anheuser-Busch Inbev and Ampar, Ineos Aromatics, Victaulic Europe, Eval Europe, SJM Coordination Center, Vasco Group and Astra Sweets, Flir Systems Trading Belgium, ZF CV Systems Europe, Henkel Belgium, Mayekawa Europe, Celio International, Dow Silicones and Vinventions.

- (iii) The scheme at issue granted its beneficiaries a selective advantage, which was not justified by the nature or the general scheme of the Belgian tax system; and
- (iv) The scheme had resulted in a distortion of competition.

Belgium opted not to appeal the CJEU's judgment.

e. *The Apple Case*

(1) *Commission decision of August 30, 2016*



Source: https://ec.europa.eu/commission/presscorner/detail/en/IP_16_2923#:~:text=The%20European%20Commission%20has%20concluded,now%20recover%20the%20illegal%20aid.

Commission Decision (EU) 2017/1283 of August 30, 2016 on State aid SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP) implemented by Ireland to Apple⁹⁹⁰ related to tax rulings issued by Ireland on January 29, 1991 and May 23, 2007 to:

- (i) Apple Operations Europe International (AOE), the successor of Apple Computer Ltd. (ACL); and
- (ii) Apple Sales International (ASI), the successor of Apple Computer Accessories Ltd. (ACAL);

two Irish-incorporated subsidiaries of Apple, Inc., conducting the following operations through branches in Ireland: (a) manufacturing and provision of support services to related companies; and (b) procurement, sales and distribution, respectively.

In the 1991 tax ruling, the Irish tax authorities indicated their agreement with the computation of ACL's chargeable profit in Ireland, relating to income from its Irish branch, on the basis of the following elements:

- (i) 65% of that branch's operating costs up to a specified annual amount and 20% of its operating costs in excess of that amount;
- (ii) If the overall profit of ACL's Irish branch was less than the figure obtained using that formula, that lower figure was to be used to determine the branch's net profit;

(iii) The operating costs to be taken into consideration for that calculation were to include all operating expenses, excluding materials for resale and cost-share for intangibles charged from companies affiliated with the Apple Group;

(iv) A capital allowance could be claimed, provided it did not exceed by a specified amount the depreciation charged in the relevant accounts.

On the other hand, the Irish tax authorities accepted the computation of ACAL's chargeable profit in Ireland, relating to income from its Irish branch to be based on a margin of 12.5% of operating costs (excluding materials for resale.)

In the 2007 tax ruling, the Irish tax authorities accepted a revised method for determining the tax base of the Irish branches of ASI and AOE.

(i) Regarding the Irish branch of ASI (the successor to Apple Computer International, itself the successor to ACAL), the chargeable profit to be allocated to that branch corresponded to a specified portion of its operating costs, excluding costs such as sums invoiced from affiliated companies within the Apple Group and material costs.

(ii) Regarding AOE's Irish branch, the chargeable profit was to correspond to the sum of:

- (a) An amount corresponding to a specified portion of the branch's operating costs, excluding costs such as the sums invoiced from affiliated companies within the Apple Group and material costs; and
- (b) An amount corresponding to the IP return for the manufacturing process technology developed by that branch, namely a specified portion of that branch's turnover.

⁹⁹⁰ <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32017D1283>.

A deduction was to be allowed in respect of capital allowances for plant and buildings “computed and allowed in the normal manner.”

The Commission Decision noted that:

(i) First, the contested tax rulings had been granted by the Irish tax administration and were therefore imputable to the State. Insofar as those rulings entailed a reduction in the amount of ASI and AOE’s tax liability, Ireland had renounced tax revenue, which had given rise to a loss of State resources.

(ii) Second, as ASI and AOE were part of the Apple Group, operating in all Member States, the contested tax rulings were liable to affect trade within the European Union.

(iii) Third, insofar as the tax rulings had led to a reduction in ASI and AOE’s tax bases, for the purposes of establishing corporation tax in Ireland, they conferred an advantage on those two companies.

In addition, according to the Commission, as the tax rulings were granted only to ASI and AOE, it could be presumed that they were selective in nature.

However, for the sake of completeness, the Commission contended that the tax rulings constituted a derogation from the reference framework, namely the ordinary rules of corporation tax in Ireland.

(iv) Fourth, if the tax rulings were held to entail a reduction in the amount of ASI and AOE’s tax liability, those rulings would be liable to improve the competitive position of those two companies and, accordingly, distort or threaten to distort competition.

The Commission Decision followed the three-step analysis derived from case law to prove the existence of a selective advantage in the case at issue.

(i) First, it identified the reference framework (namely, the ordinary rules of taxation of corporate profit in Ireland, the objective of which was to tax the profits of all companies subject to tax in Ireland) and provided grounds for applying the arm’s length principle in that case (thereby relying on the CJEU judgment in *Belgium and Forum 187 v. Commission* and deriving from that judgment the existence of a *sui generis* EU law arm’s length standard, as it did in the *Fiat* and *Starbucks* cases, see XVI.C.2.c.(1) and (2), above).

As regards the OECD guidelines, the Commission indicated that these constituted simply useful guidance for tax authorities, to ensure that the profit allocation and transfer pricing methods produced outcomes in line with market conditions.

(ii) Second, the Commission examined whether there was a selective advantage arising from a derogation from the reference framework. In essence, relying on the primary, subsidiary and alternative lines of reasoning, the Commission considered that the contested tax rulings had enabled ASI and AOE to reduce the amount of tax for which they were liable in Ireland during the period when those rulings were in force (namely the period from 1991 to 2014), and

that this represented an advantage as compared with other companies in a comparable situation.

(iii) As a subsidiary argument, in recitals 325 to 360 of the Commission Decision, it is contended that, even if the Irish tax authorities had been correct in accepting the assumption that the Apple IP licenses held by ASI and AOE had to be allocated outside Ireland, the profit allocation methods approved by the contested tax rulings had nonetheless resulted in an annual chargeable profit for ASI and AOE in Ireland, which departed from a reliable approximation of a market-based outcome in line with the arm’s length principle.

According to the Commission, those methods were based on inappropriate methodological choices, which had led to a reduction in the amount of tax that ASI and AOE were required to pay as compared with non-integrated companies whose chargeable profits under those rules were determined by prices negotiated at arm’s length on the market.

Therefore, according to the Commission, the contested tax rulings, by approving those methods, had conferred a selective advantage on ASI and AOE for the purposes of Article 107(1) TFEU.

Ireland (Case T-778/16) and ASI and AOE (Case T-892/16) appealed the Commission Decision before the EU General Court on November 9, 2016 and December 19, 2016, respectively.

(2) Judgment of the EU General Court of July 15, 2020

On July 15, 2020, the EU General Court annulled the Commission Decision.⁹⁹¹

At the outset, the Court confirmed the Commission’s competence to review tax rulings for compliance with State aid rules.

It further admitted that the Commission had identified the correct reference system against which to compare Apple’s tax arrangements.

- In this regard, Apple and Ireland had argued that the Commission had wrongly sought to compare the situation of ASI and AOE with that of ordinary Irish tax resident companies.

- Although incorporated in Ireland, ASI and AOE were not tax resident in Ireland, and their taxation was subject to specific rules set out in section 25 of the Irish Taxes Consolidation Act 1997 (as amended) (TCA 97).

- The Court dismissed this argument. While section 25 laid down specific rules for the determination of the chargeable profits of nonresident Irish entities, it did not mean that they were not in a comparable situation to resident companies since the objective of the Irish tax system was to ensure that all entities (both resident and nonresident) paid the same rate of tax on their chargeable profits.

The Court held that the Commission was correct to apply the “arm’s-length principle.” Broadly following its reasoning in *Starbucks* (see XVI.C.2.c.(1) and (2), above), the Court found

⁹⁹¹ Case T-778/16, *Ireland v. Commission* and Case T-892/16, *Apple Sales International and Apple Operations Europe v. Commission*.

that for the arm's-length principle to be applied "it must be clear from national tax law that the profits derived from the activities of the branches of non-resident undertakings should be taxed as if they resulted from the economic activities of stand-alone undertakings operating under market conditions."

- Since, as noted above, the Court had concluded that the Irish tax system pursued the same objective of the taxation of chargeable profits in relation to both resident and non-resident companies, the arm's-length principle could be used to verify that the profits of ASI and AOE had been appropriately allocated.

Finally, according to the Court, the Commission could not be criticized for having relied, in essence, on the Authorized OECD Approach, when it noted that, for the purposes of applying section 25 of TCA 97, the allocation of profits to the Irish branch of a nonresident company had to take into account the allocation of assets, functions and risks between the branch and the other parts of that company.

To expand on the approach under which a PE is considered for the purposes of computing its taxable income, to be a separate and independent enterprise engaged in the same or similar activities under the same or similar conditions. Under the OECD AOA, the profits of the different parts of an enterprise are allocated based on a fiction that a PE is a distinct and separate entity (a "functionally separate entity"), implying — in certain circumstances — the recognition of "internal dealings" (e.g., internal loans and interest charges) between a PE and its head office or the rest of the enterprise of which it is a part. The interpretation of OECD Model Convention, Art. 7(2) under the AOA is that a two-step analysis is required.

First, a functional and factual analysis, conducted in accordance with the guidance found in the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (the "OECD Guidelines"), must be performed. This is to hypothesize appropriately the PE and the remainder of the enterprise (or a segment or segments of the enterprise) as if they were associated enterprises, each undertaking functions, owning and/or using assets, assuming risks, and entering into dealings with each other and transactions with other related and unrelated enterprises (determination of the "significant people functions" (SPF) of the PE).

Under the first step, the functional and factual analysis must identify the economically significant activities and responsibilities undertaken by the PE. To the extent relevant, this analysis should consider the PE's activities and responsibilities in the context of the activities and responsibilities undertaken by the enterprise as a whole, particularly those parts of the enterprise that engage in dealings with the PE. Under the second step (determination of the business relations between the PE and its head office), the remuneration of any dealings between the hypothesized enterprises is determined by applying by analogy the Art. 9 transfer pricing tools (as articulated in the OECD Guidelines for separate enterprises) by reference to the functions performed, assets used and risk assumed by the hypothesized enterprises.

The result of these two steps will be to allow the calculation of the profits (or losses) of the PE from all its activities, including transactions with other unrelated enterprises, transactions with related enterprises (with direct application of the

OECD Guidelines) and dealings with other parts of the enterprise (under step 2 of the AOA). Under the AOA, profits may be attributed to a PE even though the enterprise as a whole has never made profits; conversely, the AOA may result in no profits being attributed to a PE even though the enterprise as a whole has made profits.

To this extent, the Court accepted the application of this approach generally by the Commission. However, according to the Court, the Commission failed to prove that the allocation of profits was incompatible with the "arm's-length principle."

- In this regard, the Commission had argued that Apple Group IP licenses held by ASI and AOE should have been allocated (in their entirety) to Irish branches of ASI and AOE, implying that all of the profit arising from those IP licenses would be taxable in Ireland.
- The Court disagreed with the Commission's assessment by emphasizing that the relevant Irish tax laws only required the profits arising from the licenses to be allocated to ASI and AOE where it could be shown that the licenses were controlled by the Irish branches.
- To this end, the Court placed the Irish branches in a supporting role, with the strategic function sitting with the head offices, i.e., at the Cupertino HQ.
- As such, Irish tax law did not require that the income generated from the IP licenses be taxed in Ireland. In other words, it was not proven that the allocation of the IP to the head office was a deviation from Irish law or that it was contrary to the outcome that would have been arrived at under market conditions.

The EU General Court concluded that the Commission Decision had not succeeded in demonstrating that Ireland had conferred an economic advantage on a selective basis to Apple through its tax rulings for the purposes of the EU State aid rules.

In other words, according to the Court, the Commission had not succeeded in demonstrating "to the requisite legal standard" that the tax rulings at issue triggered a "selective advantage."

The Commission appealed the EU General Court's judgment on September 25, 2020.⁹⁹²

(3) *Opinion of Advocate General Pitruzzella of November 9, 2023*

On November 9, 2023, largely based on the reasoning set out in XVI.C.2.e.(4) below, Advocate General Pitruzzella opined that the CJEU should set aside the General Court's judgment and refer the case back.

(4) *Judgment of the CJEU of September 10, 2024*

The CJEU, in Grand Chamber composition, did not remand the case to the General Court (as suggested by the Advocate General), considering that it had all the information necessary to rule on all the pleas at hand and, hence, that it was itself in a position to issue a final decision in the matter.

⁹⁹² Case C-465/20 P, *Commission v. Ireland and Others*.

The CJEU set aside the judgment of the General Court, thereby upholding the Commission Decision in its entirety, essentially on the following grounds:

(i) The Commission Decision is based on the premise that the application of Section 25 of the TCA 97 required the prior determination of a profit allocation method, which is not defined in that provision, and, moreover, that that method had to lead to an outcome consistent with the arm's length principle, a premise that was not called into question by the General Court. Moreover, the General Court explicitly acknowledged that the application of Section 25, as described by Ireland, corresponded in essence to the functional and factual analysis conducted as part of the first step of the AOA. The purpose of that first step was to identify the assets, functions and risks that must be allocated to a company's PE. In other words, as the Commission's right to rely on the AOA had not been cross appealed, the CJEU found itself to be bound to give its ruling within that framework.

(ii) It was not the finding that the head offices had neither employees nor physical presence outside the Irish branches that led the Commission to conclude that the IP licenses and related profits had to be allocated to those branches. Instead, the Commission drew that conclusion after linking two separate findings: on the one hand, the absence of active or critical functions performed and risks assumed by the head offices; and (ii) on the other hand, the multiplicity and centrality of the functions performed and risks assumed by those branches. The General Court therefore erred in law when it found, by misinterpreting the decision at issue, that the Commission had confined itself to an "exclusion" approach in its primary line of reasoning.

(iii) In its examination of the Commission's findings with regard to activities within the Apple Group, the General Court focused on the functions and risks assumed by Apple Inc. in relation to IP, instead of concentrating solely on the activities performed by the Irish branches and by the head offices, respectively, of ASI and AOE in relation to the management and exploitation of the IP licenses. The General Court thus proceeded to characterize the facts examined by applying a different legal test from that which the Court had itself considered applicable under Section 25 of the TCA 97. That reference framework requires account to be taken of the allocation of assets, functions and risks between the branch and the other parts of the nonresident company and, in accordance with the tax principles applicable under Irish law, precludes the role of separate entities, such as a parent company of the nonresident company, from being taken into consideration.

(iv) In its joint examination of advantage and selectivity, the Commission correctly followed the three-step selectivity analysis of a national tax measure: identification of the appropriate reference system; assessment as to whether the measures at issue constitute a derogation from that system; and assessment as to whether such a derogation is justified by the nature and general scheme of that system.

(v) The Commission did not err when it found, in the decision at issue, that Ireland had renounced tax revenue

from ASI and AOE since the contested tax rulings endorse methods for allocating profits that produce an outcome that separate and standalone undertakings operating under normal market conditions would not have accepted. Those tax rulings reduce the chargeable profits of ASI and AOE for purposes of applying Section 25 of the TCA 97 and, therefore, the amount of corporation tax that they are required to pay in Ireland, as compared to other companies taxed in Ireland whose chargeable profits reflect prices determined on the market in line with the arm's length principle. Such measures therefore mitigate the charges that are generally included in the budget of an undertaking.

(vi) The Commission did not commit an error of law by requiring Ireland to recover the aid at issue. Such an obligation contravenes neither the principle of legal certainty nor the principle of the protection of legitimate expectations.

(vii) The Commission did not offend against the principle of non-retroactivity by basing its decision on an AOA that post-dated the contested tax rulings. As the Commission stated in the decision at issue, its approach is based on an infringement of Article 107(1) of the TFEU, which has been part of Ireland's legal order since its accession to the European Union in 1973, and not on a failure to have regard to the framework defined at the OECD level. The Commission referred to that framework only insofar as it offered valuable guidance for the purpose of determining whether a method for fixing the taxable profit of a branch produces a reliable approximation of a market-based outcome in line with the arm's length principle.

(viii) The Commission did not unilaterally apply the substantive tax rules and carry out a de facto tax harmonization when it analyzed whether the chargeable profits of ASI and AOE in Ireland, calculated in accordance with the profit allocation methods endorsed by the contested tax rulings, corresponded to profits that, had those tax rulings not been issued, would have been imputed to the Irish branches of those two companies under Section 25 of the TCA 97, in view of the functions performed, the assets used and the risks assumed by those branches.

Comment: The decision of the CJEU in *Apple* came as a surprise to many. First, the decision seems to deviate from the earlier Court's holdings in *Fiat* and *Amazon*, following which the OECD Transfer Pricing Guidelines are not legally binding if not incorporated into the domestic law of the relevant Member State and, as such, cannot form part of the "reference framework" for purposes of a State aid assessment. This reasoning now seems to have been overruled or, at least, abandoned in that it would now be sufficient that the application of domestic law "corresponds in essence" to the functional and factual analysis conducted as part of the first step of the Authorized AOA. The aim of that first step is to identify the assets, functions and risks that must be allocated to a company's PE. The "correspondence in essence" standard undoubtedly falls short of the requirement of "explicit reference" to international principles in *Fiat* and *Amazon*. The position also seems difficult to reconcile with the CJEU's decision in *CFC*, rendered barely nine days after the *Apple* judgment, in which, in line with the *Fiat* and *Amazon* decisions, the CJEU reiterated that deference

is to be placed on the fiscal autonomy that allows a Member State to define its own system of taxation.

Second, it is awkward that the AOA is retained as a reference point. Not only was the AOA formulated in the context of the interpretation of tax treaties and not of domestic law, it was also introduced at the OECD level only in 2010. While endorsed by the OECD member states, the question still arises as to how the AOA may be relevant to the assessment of a fact pattern that goes back to the early nineties (i.e., the time at which the *Apple* rulings were issued by Ireland). In this respect, also, the rejection of the retroactivity argument by the Court (see above) is, in the author's view, far from convincing, especially when tested against the general principle of legal certainty requiring rules of law to be known, clear, precise, stable, certain and predictable (leaving aside the very question as to whether the AOA may in fact be considered a "rule of law" (quod non)).

Third, even if it were considered correct to analyze the technical position by reference to the AOA, it is not possible to conclude – as the CJEU does – that the activities of other entities in generating the profits should not be taken account of in the analysis of the profits that belong to the branches. This follows from the core requirement of the provisions in tax treaties (specifically provisions that correspond to Article 7 (2) of the OECD Model Convention) that the AOA was designed to clarify. This requires a focus on the activities of the relevant branch/PE in answering the question, broadly, of what profits a hypothetical distinct and separate enterprise would be expected to derive if it carried on the same activities (under the same conditions) as those actually carried on in the branch/PE. In other words, the AOA starts by analyzing the activities in the branch to determine, by reference to those activities, what profits should be taxed in the hands of the branch. In its *Apple* de-

cision, the CJEU seems to do the opposite, i.e. it starts not with the activities of the branch but with the profits of the entity. Those profits are then allocated by taking account only of the activities of the legal entity (thus ignoring the contribution of other group entities). Specifically, according to the CJEU, Irish law required that both the activities of the head office and those of the Irish branch be compared when allocating profit to the branch, while Irish case law had in fact supported the position that only the branch should be looked at and profit should be allocated based on the activities carried on in Ireland alone.

Comment: To comply with the 2016 Commission Decision, the alleged State aid was placed by Apple into an Escrow Fund with the proceeds to be released only when there was a final determination in the European Courts. The CJEU judgment provides the final determination in this case and the process of transferring the assets in the Escrow Fund to Ireland will now commence. As of September 9, 2024, the value of the Escrow Fund was in the order of 14.1 billion euros. The Escrow Fund is invested in short-dated, highly rated, liquid fixed income instruments that will be realized over the coming months. Funds will be released from Escrow following the issue of tax assessments by the Irish Revenue Commissioners in accordance with the Escrow Framework Deed. Tax payments will be made to the Irish Revenue Commissioners and, in turn, to the Irish Exchequer. The full balance in the Fund, after fees and operational expenses are paid, will accrue to the State. These processes are likely to take at least six months.

f. The Amazon Case

(1) Commission Decision of October 4, 2017



Source: https://ec.europa.eu/commission/presscorner/detail/en/IP_17_3701.

Commission Decision of October 4, 2017 on State Aid SA.38944 (2014/C) (ex 2014/NN) implemented by Luxembourg to Amazon⁹⁹³ concerned a tax ruling issued by the Luxembourg tax authorities on November 6, 2003.

The ruling allowed Amazon to establish a structure where-

(i) Two US parent companies (Amazon US) owned 100% of Amazon Europe Technologies Holding SCS (LuxSCS), a Luxembourg limited liability partnership (considered to be a transparent entity for Luxembourg tax purposes);

⁹⁹³ https://ec.europa.eu/competition/state_aid/cases/254685/254685_1966181_892_2.pdf.

(ii) LuxSCS, in turn, wholly owned Amazon EU Sarl (LuxOpCo), a Luxembourg limited liability company, that operated all of Amazon's European websites and acted as Amazon headquarters in Europe, recording Amazon's European profits.

Under the structure:

- LuxSCS licensed Amazon US's IP for use in Europe to LuxOpCo, a tax-deductible expense for LuxOpCo.
- Due to LuxSCS's treatment as a fiscally transparent entity in Luxembourg, royalty payments from LuxOpCo to LuxSCS were not considered as taxable income of LuxSCS in Luxembourg, but of its partners in the US (who were deemed not to have a PE in Luxembourg).
- Since the US did not consider LuxSCS as fiscally transparent, but, rather, as a separate corporate entity resident in Luxembourg, the taxation of the LuxSCS's partners in the US could be deferred indefinitely, as long as none of LuxSCS's profits were repatriated to the US (hybrid mismatch).
- In addition, for the transfer pricing arrangement of the license fee, Luxembourg allowed Amazon to base the fee each year on:
 - The EU operating profit less a LuxOpCo return equal to the lesser of 4–6% of LuxOpCo's total EU operating expenses for the year; or
 - The total EU operating profit attributable to the websites, whereby the LuxOpCo return could not be less than 0.45% of the EU revenue or more than 0.55% of the EU revenue.

In the Commission Decision, the Commission considered that LuxOpCo's tax base was unduly reduced by royalty payments to LuxSCS under the licensing agreement. The Commission made its own calculation of an arm's length royalty (referring to its own interpretation of the arm's length principle and the OECD guidelines) and considered the taxes reduced according to any excess paid by LuxOpCo as a selective and, hence, unlawful advantage.

Luxembourg (Case T-816/17) and Amazon EU Sarl and Amazon.com, Inc. ("Amazon") (Case T-318/18) lodged an appeal before the EU General Court against the Commission Decision on December 14, 2017 and May 22, 2018 respectively.

(2) Judgment of the EU General Court of May 12, 2021

In its judgment of May 12, 2021, the EU General Court concluded that "none of the findings set out by the Commission in the contested decision are sufficient to demonstrate the existence of an advantage for the purposes of Article 107(1) TFEU, with the result that the contested decision must be annulled in its entirety."

Specifically, the Court denied the existence of an advantage, let alone a selective advantage, on the following grounds:

- (i) First, the Commission had erred in its functional analysis by considering the partnership at hand to be a mere passive holder of the relevant intangible assets, when the partnership was assuming significant other risks and functions,

including, in particular, the exploitation of the intangible assets;

- (ii) Second, the Commission, in its overall methodology, had taken into consideration neither the remuneration of the services rendered by the partnership, which were not low value-adding services, nor the subsequent increase in value of the intangible assets held;

- (iii) Finally, the Commission had not justified why the functions assumed by the operational company should have led to a higher remuneration and had not demonstrated that the use of another transfer pricing method would have resulted in a smaller reduction of the tax base.

The Court's judgment in *Amazon* makes it abundantly clear that criticizing the transfer pricing methods applied by a Member State's tax authorities is not sufficient to demonstrate preferential tax treatment (in this case, the existence of a selective tax advantage).

This is in line with the earlier judgments of the Court in *Starbucks* and *Apple*.

It appears that the Commission lost the cases mainly because of the alleged inconsistencies and errors in presenting a solid and convincing "counter" functional analysis.

An appeal was lodged on July 27, 2021 by the Commission before the CJEU against the decision of the EU General Court (Case C-457/21 P).

(3) Judgment of the CJEU of December 14, 2023

In its judgment of December 14, 2023, the CJEU confirmed, in line with the *Fiat* case, that the arm's length principle had no autonomous existence in EU law.

- The Court also confirmed that the OECD transfer pricing guidelines and the arm's length principle could not be considered in the examination of the reference system under Luxembourg law, unless the Luxembourg tax system made *explicit* reference to them.

- Hence, the Commission had erred in law when determining the reference system by taking into account parameters and rules external to the national tax system in question, such as the OECD transfer pricing guidelines that aim to clarify the arm's length principle — which was not even part of Luxembourg tax law at the time when the rulings were issued.

- According to the CJEU, neither the Commission nor the General Court should have analysed the rulings from the perspective of the OECD transfer pricing guidelines and the arm's length principle that was not part of Luxembourg tax law.

The CJEU thereby followed the Opinion issued by Advocate General Kokott on June 8, 2023.⁹⁹⁴

In her Opinion, the Advocate General had contended, in line with the decision of the CJEU and the Opinion of Advocate Pikamäe in the *Fiat* case (see XVI.C.2.b.(3), above), that the Commission had not taken into account the Luxembourg national law in force when the tax ruling was issued but rather the

⁹⁹⁴ Opinion of Advocate General Kokott, Case C-457/21 P, *Commission v. Amazon.com and Others*.

OECD Transfer Pricing Guidelines (to which the Luxembourg national law did not refer at that time) as the relevant reference system for its review of a selective advantage.

- The Commission therefore erred in law in applying Article 107(1) of the TFEU and, consequently, all the subsequent considerations in the Commission Decision were also vitiated by that error of law.
- The EU General Court was therefore correct in annulling the Commission decision at issue — albeit on different grounds — in the absence of a demonstrated selective advantage.
- In other words, while the judgment under appeal was correct in its outcome — albeit for reasons other than those on which the EU General Court relied — the Commission Decision had to be annulled because the reference system (the OECD Transfer Pricing Guidelines instead of Luxembourg law) relied on by the Commission was incorrect.

In line with the Advocate General's Opinion, despite the fact that the General Court had relied on a wrong reference system, the CJEU considered that the operative part of the judgment annulling the Commission's decision could be justified on other grounds.

The Court of Justice therefore decided to make a substitution of grounds and directly rule in the last instance by annulling the Commission Decision.

By Commission Decision of November 28, 2024 Brussels, 28.11.2024 on tax ruling SA.38944 (2014/C) (ex 2014/NN) — Luxembourg, alleged aid to Amazon (C (2024) 8565 final), addressed to the Grand Duchy of Luxembourg, the Commission confirmed that “the contested tax ruling issued by the tax administration of the Grand Duchy of Luxembourg on November 6, 2003 in favor of Amazon did not constitute State aid within the meaning of Article 107(1) of the TFEU”.

g. The ENGIE Case

(1) Commission Decision of June 20, 2018



Source: https://ec.europa.eu/commission/presscorner/detail/en/ip_18_4228.

Commission Decision (EU) 2019/421 of June 20, 2018 on State aid SA.44888 (2016/C) (ex 2016/NN) implemented by Luxembourg in favor of ENGIE⁹⁹⁵ concerns two sets of Luxembourg tax rulings, issued as from September 2008, dealing with the tax treatment of two similar intragroup transactions implemented by Engie between four companies in the EDF (previously: GDF Suez) group, all based in Luxembourg.

- In both cases, Engie transferred a set of assets constituting a fully functional business activity to a subsidiary in Luxembourg (subsequently to run this business activity).
- The payment of the price by the subsidiary was financed by means of a 15-year interest-free mandatorily convertible loan (*zéro intérêts obligation remboursable en actions* or “ZORA.”)
- The ZORA did not bear any periodic interest but, at conversion, the subsidiary would pay to the lender:

- Shares representing the nominal of the ZORA;
- Plus a “bonus” consisting in all the profits realized by the subsidiary during the life of the ZORA;
- Minus a limited margin agreed with the Luxembourg tax authorities (the “ZORA Accretions.”)

• The following convertible loans were granted:

- The first convertible loan was granted in 2009 by LNG Luxembourg (lender) to GDF Suez LNG Supply (borrower);
- The second convertible loan was granted in 2011 by Electrabel Invest Luxembourg (lender) to GDF Suez Treasury Management (borrower).

• In turn, an intermediary group entity simultaneously financed this loan by means of a Prepaid Forward Sale Contract entered into with a holding also resident in Luxembourg and the sole shareholder of both the subsidiary and the intermediary entity.

• Under the Prepaid Forward Sale Contract, the holding paid to the intermediary company an amount equal to the

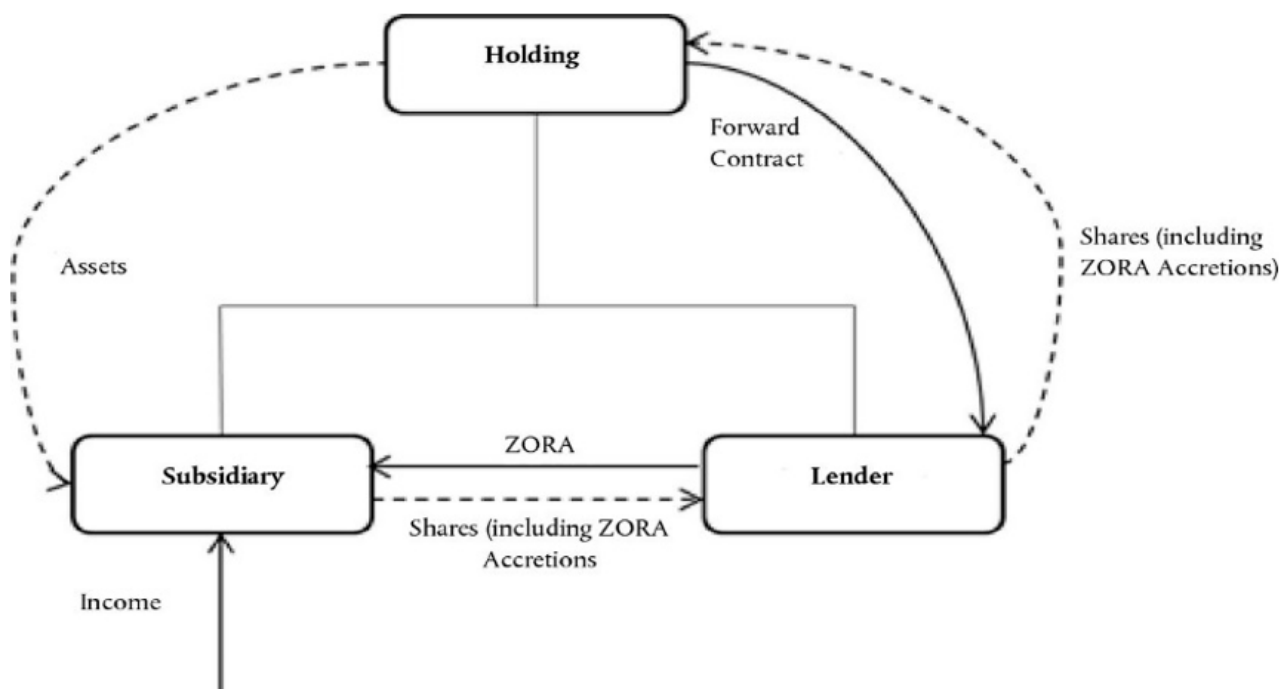
⁹⁹⁵ <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32019D0421>.

nominal of the ZORA against the acquisition of the rights to the shares that the subsidiary was to issue at conversion of the ZORA.

• Therefore, if the subsidiary had realized profits during the life of the ZORA, the holding received at conversion of the ZORA the shares incorporating the value of the ZORA Accretions.

• Consequently, the holding provided to the subsidiary the financing for the acquisition of the assets by means of the Prepaid Forward Sale Contract and the ZORA.

The Commission Decision illustrated this set-up as follows:



• The Luxembourg tax rulings at issue agreed that the subsidiary was entitled to deduct, every year, provisions for the ZORA Accretions to be paid at conversion, implying that the subsidiary was not taxed, except for a limited margin agreed with the tax authorities.

• Upon realization of the ZORA Accretions by the holding, this profit was tax exempt pursuant to the Luxembourg participation exemption regime.

• The intermediary entity was also not subject to tax since the profit realized from the conversion of the ZORA (the ZORA Accretions) was compensated by a loss of the same amount resulting from the Prepaid Forward Sale Contract.

• The final result was that the ZORA Accretions were deducted at the level of the subsidiary and that the same amount was also not subject to tax at the level of the holding, as it was considered a tax-exempt income.

• Therefore, under the tax rulings, the ZORA Accretions, which represented virtually all the profit realized by the subsidiary during the life of the ZORA, remained untaxed in Luxembourg.

The Commission Decision focused on the combined effect of:

- (i) The deductibility of the ZORA Accretions; and
- (ii) The exemption of the corresponding income.

It established that the conditions for State aid to exist were all satisfied, e.g.:

- (i) “Intervention by the State or through State resources;”
- (ii) “Affection of trade between Member States;” and
- (iii) “Distortion or threatened distortion of competition.”

The Commission then turned to the “selective advantage” condition.

In that regard, the Commission stated that where a tax ruling endorsed a tax treatment that did not reflect what would result from a normal application of the ordinary tax system, without justification, the measure would confer a selective advantage on its addressee in so far as that tax treatment resulted in improving the financial position of that undertaking in the Member State as compared to undertakings in a comparable factual and legal situation in the light of the objective of the tax system.

The Commission considered that, in the case at issue, the existence of a selective advantage — the Commission referred to a *prima facie* selective advantage — was established by its analysis of the effects of the tax treatment both at:

- (i) The individual level of the entities involved; and
- (ii) Group level.

In its assessment of the “selective advantage” the Commission used as the “reference framework:”

(i) First, the general Luxembourg corporate income tax system (the objective of which was the taxation of the profit of all companies subject to tax in Luxembourg, as determined in their accounts); and

(ii) Second, from a narrower perspective, the rules of the general Luxembourg corporate income tax system that governed:

(a) The participation exemption; and

(b) The taxation of profit distributions.

The Commission found that the tax treatment granted on the basis of the contested tax rulings constituted a derogation from both reference frameworks.

As an alternative line of reasoning, the Commission referred to the Luxembourg domestic anti-abuse provision as the reference framework.

• According to this provision, if the legal form or the construction surrounding a transaction was not appropriate in terms of its substance, tax should have been assessed in accordance with the substance of the transaction, as if it had been concluded in the appropriate legal form.

According to the Commission, the Luxembourg tax administration should not have issued the tax rulings, as the structures set up by Engie were abusive within the meaning of that provision, i.e., if the transactions had been set up as (economically equivalent) direct financing transactions between the holdings and the subsidiaries at issue, be it in the form of equity or debt instruments (rather than through the complex structures used by Engie), that would have led to the taxation of the underlying profit.

Consequently, in the Commission's view, Engie set up the complex structures solely to achieve significant tax savings. Under this alternative line of reasoning, the Commission concluded the existence of a "selective advantage" since the advantage granted to Engie on the basis of the tax rulings was based on a misapplication of the law which, by definition, is not available to any other undertakings.

Luxembourg (Case T-516/18) and Engie Global LNG Holding Sàrl, Engie Invest International SA and Engie SA ("Engie"), on August 30, 2018 and September 4, 2018, respectively, lodged an appeal before the EU General Court, seeking annulment of the Commission Decision.

(2) Judgment of the EU General Court of May 12, 2018

In its judgment of May 12, 2021,⁹⁹⁶ the General Court rejected all of the pleas formulated by Luxembourg and Engie and, consequently, dismissed the actions in Cases T-516/18 and T-525/18 in their entirety.

The EU General Court concluded that "[it] approves the Commission's approach, when presented with a complex intra-group financing structure, which entails looking at the economic and fiscal reality, rather than a formalistic approach that takes in isolation each of the transactions under the structure."

In other words, State aid may be found to exist based on the effects of a set of transactions rather than a consideration of each transaction separately.

Specifically, the Court rejected the pleas submitted by ENGIE and Luxembourg alleging, in essence, errors of assessment and law in the identification of a selective advantage giving rise to State aid.

• In examining those pleas, the Court rejected the arguments alleging confusion of the conditions for:

◦ Finding an advantage; and

◦ Demonstrating the selectivity of the contested tax rulings.

• In that regard, the Court pointed out that, having regard to the fiscal nature of the contested rulings, those two conditions might be assessed simultaneously.

• According to the Court, in tax matters, the examination of an advantage overlapped with the examination of selectivity insofar as, for those two conditions to be fulfilled, it had to be demonstrated that the contested tax measure led to a reduction in the amount of tax that would normally have been payable by the recipient of the measure under the ordinary tax regime and, therefore, applicable to other taxpayers in the same situation.

• In the instant case, the Court noted that the Commission had sought to demonstrate that the contested tax rulings led to a reduction in the amount of tax which would normally have been payable under the ordinary tax regime and that, consequently, those measures constituted a derogation from tax rules applicable to other taxpayers in the same factual and legal situation.

The Court subsequently rejected the arguments relating to the absence of a selective advantage at the level of the holding companies in the light of a narrow reference framework established based on Luxembourg tax provisions relating to:

(i) The taxation of profit distributions; and

(ii) The participation exemption.

• As regards the definition of that reference framework, after stating that it was apparent from an analysis of those tax provisions that the participation exemption was applicable only to income that had not been deducted from the taxable income of subsidiaries, the Court found that the Commission had not erred in law in determining that the participation exemption at the level of a parent company was dependent on the taxation at the level of its subsidiary of profits distributed by that subsidiary.

• As regards the identification of a derogation from the defined reference framework, the Court stated that, contrary to a formalistic approach that entailed taking in isolation each of the transactions that made up the sophisticated financing structure, it was important to go beyond the legal form in order to look at the economic and fiscal reality of the structure.

• In the instant case, the Court noted that the contested tax rulings approved various transactions that constituted a system for implementing, in a circular and interdependent fashion, the transfer of a business activity and

⁹⁹⁶ Joined Cases T-516/18 and T-525/18, *Luxembourg e.a. v. Commission*.

its financing between three companies belonging to the same group.

- Those transactions were designed to be implemented in three successive but interdependent stages, involving the intervention of:

- A holding company;
- An intermediary; and
- A subsidiary.

- In those circumstances, the Court considered that the Commission had been entitled to determine that the Luxembourg tax administration had derogated from the reference framework by confirming the exemption, at the level of the holding companies, of participations which corresponded, from an economic perspective, to an amount that was deducted, as part of an intragroup financing structure, as expenses at the level of the subsidiaries.

- In the light of the links established by the Commission within that structure, the Court found that the Commission had not erred in law by looking at the combined effect, at the level of the holding companies, of:

- The deductibility of income at the level of a subsidiary; and
- The subsequent exemption of that income at the level of the subsidiary's parent company.

- On that basis, the Court concluded that the Commission had demonstrated the selectivity of the contested tax rulings in the light of the narrow reference framework.

Further, the Court concurred with the Commission's analysis of the selectivity of the contested tax rulings in the light of the provision relating to abuse of law, as an integral part of the Luxembourg corporate income tax system.

- The Court found that it could not be disputed that the Engie group had received preferential tax treatment owing to the non-application, in the contested tax rulings, of the provision relating to abuse of law.

- In the light of the objective pursued by the provision relating to abuse of law, namely to combat abusive practices in tax matters, Engie and, in particular, the holding companies were in the same factual and legal situation as all Luxembourg taxpayers, which could not reasonably expect to also benefit from the non-application of the provision relating to abuse of law in cases where the conditions for its application had been fulfilled.

Consequently, the Court held that the Commission had demonstrated to the requisite legal standard a derogation from the reference framework comprising the provision relating to abuse of law.

Luxembourg (Case C-451/21 P) and Engie Global LNG Holding Sàrl, Engie Invest International SA and Engie SA ("Engie") lodged appeals before the CJEU against the decision

of the EU General Court, respectively on July 21, 2023 and July 22, 2023.

(3) *Judgment of the CJEU of December 5, 2023*

In her Opinion of May 4, 2023,⁹⁹⁷ Advocate General Kokott argued that the CJEU should uphold the appeals and annul the Commission decision.

In her view, the Commission and, subsequently, the EU General Court had erred in law in assuming a principle of correspondence whereby, under Luxembourg law, the use of tax exemptions for participation income would depend on taxation at the level of the subsidiary. No such principle of correspondence was manifestly apparent from Luxembourg law. Neither the Commission nor the EU General Court could judge national tax law by some ideal or fictitious tax system.

It followed that both the Commission and the EU General Court had proceeded on the basis of an incorrect reference framework and, according to settled case law, an error in determining the reference system necessarily vitiated the entire analysis of the condition relating to selectivity.⁹⁹⁸

The CJEU, in its judgment of December 5, 2023, followed the Opinion of the Advocate General and thus annulled the Commission Decision.

Specifically, the CJEU considered that the Commission had made an error in the determination of the reference framework, which vitiated the whole analysis of the condition relating to selectivity.

- The reference framework or the "normal" tax regime, from which the condition relating to selectivity must be analyzed, had to include the exemptions that the national tax authorities had considered applicable to a specific case as long as these exemptions were not obviously discriminatory and did not confer, in themselves, a selective advantage within the meaning of EU law.

- The Commission could not have therefore established a derogation from a reference framework by limiting itself, as it had done in the Engie case, to observing that a measure deviated from a general objective of taxing all resident companies in the Member State concerned, without

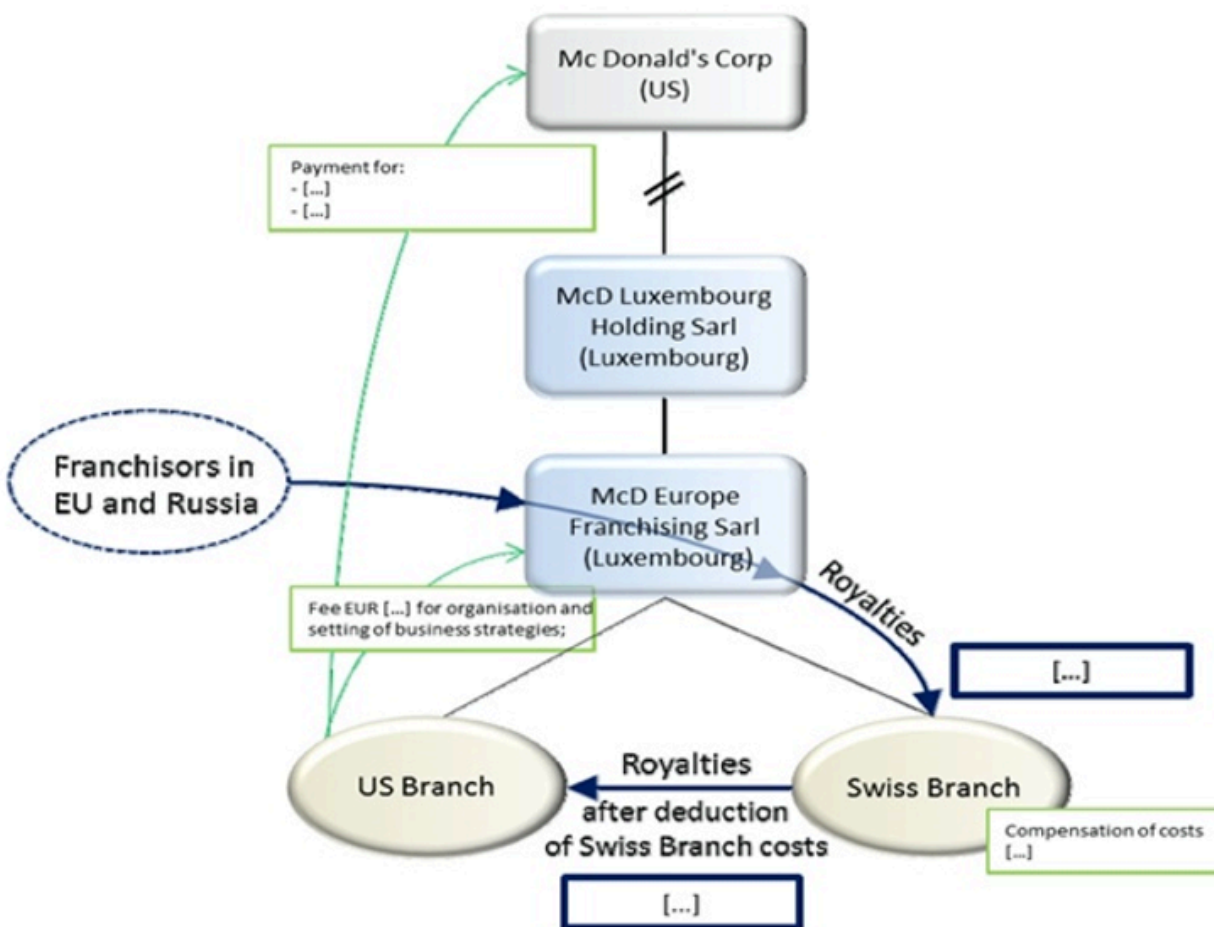
⁹⁹⁷ Opinion of Advocate General Kokott, Case C-454/21 P, *Engie Global LNG Holding and Others v. Commission* and Case C-451/21 P, *Luxembourg v. Commission*.

⁹⁹⁸ It is noteworthy that the Advocate General adds a plea for individual tax assessments (whether normal tax assessments or advance tax rulings) to be reviewed only on the basis of a restricted standard of review that is limited to a plausibility check. That would mean that not every error in the application of national tax law is evidence of a selective advantage and that only the manifest derogation in favor of the taxpayer of a tax ruling (or tax assessment) from the reference framework encompassing the national tax law can constitute a selective advantage (see the *Commission and Spain v Government of Gibraltar and United Kingdom* cases discussed at XVI.B.3.d., above); absent such manifest derogation, the tax assessment may be unlawful, but a possible derogation from the reference framework does not by itself mean that it constitutes State aid within the meaning of Article 107 of the TFEU. Likewise, in view of the peculiarities of general anti-abuse rules, the standard of review for assessing the application of such rules for compliance with State aid law should also be reduced to a pure plausibility check.

taking into account the provisions of national law specifying how this objective was to be implemented.

h. The McDonald's Case

McD Europe Franchising Sarl (2013)



Commission Decision (EU) 2019/1252 of September 19, 2018 on tax rulings SA.38945 (2015/C) (ex 2015/NN) (ex 2014/CP) granted by Luxembourg in favor of McDonald's Europe⁹⁹⁹ concerned two tax rulings granted by the Luxembourg tax authorities to McDonald's Europe Franchising.

Under those rulings, McDonald's Europe Franchising paid no corporate tax in Luxembourg on profits derived from royalties paid by franchisees operating restaurants in Europe and Russia for the right to use the McDonald's brand and associated services, despite the fact that such profits were also not taxed in the hands of McDonald's US branch (to which the royalties were transferred internally).

⁹⁹⁹ <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32019D1252>.

In response to comments made by Luxembourg, McDonald's and other interested parties, on September 19, 2018, the Commission concluded that the tax rulings at hand did not constitute State aid because they did not misapply the Luxembourg-United States tax treaty.

Rather, the lack of effective taxation of the royalties received by McDonald's Europe Franchising was the result of a mismatch between US and Luxembourg law (i.e., under Luxembourg tax law, the US branch was considered to be a PE whose revenues could not be taxed by Luxembourg, but under US tax law, the branch was not considered to constitute a PE meaning that the profits from the royalties were not subject to tax in the United States either).

Therefore, no selective tax advantage could be considered to have been granted in this context.

i. The UK CFC Group Financing Exemption Case

(1) Commission Decision of April 2, 2019



Source: https://ec.europa.eu/commission/presscorner/detail/es/IP_19_1948.

Commission Decision (EU) 2019/1352 of April 2, 2019 on the State aid SA.44896 implemented by the United Kingdom concerning CFC Group Financing Exemption,¹⁰⁰⁰ a decision in respect of what the Commission calls a “U.K. tax scheme for multinationals,” addressed the group financing exemption (GFE) from the U.K. Controlled Foreign Company (CFC) rules for the period from January 2013 to December 2018.

As background, the U.K. CFC rules were revised significantly following the CJEU’s finding in *Cadbury Schweppes* (see II.E.4.d., above) that, except in the case of wholly artificial arrangements, they violated the EU fundamental freedom of establishment principle.

The reformed rules, in force since 2013, included a number of exceptions for certain financing income (i.e., interest payments received on loans) of subsidiaries of U.K. corporate taxpayers. Under these exceptions, certain financing income received by non-U.K. subsidiaries from other non-U.K. affiliated group companies was exempt from, or only partially subject to, U.K. tax through the U.K. CFC charge. As a result, a multinational active in the United Kingdom could, in certain circumstances, provide financing to non-U.K. group companies via a non-U.K. subsidiary of a U.K. group member without triggering inclusion of the financing income in the United Kingdom. These exceptions were not available with respect to the financing income of subsidiaries that lent to U.K. affiliates or that did

not have a minimum level of business presence in their jurisdiction of residence.

According to the Commission, the GFE exempted from reallocation to the United Kingdom, and hence from U.K. taxation, financing income received by an offshore subsidiary from another foreign group company, thus allowing multinational groups a more beneficial tax treatment than other taxpayers, in breach of the EU State aid rules. Specifically, an exemption from an anti-avoidance provision (such as a CFC measure) could amount to a selective advantage under EU law: in the absence of the GFE, interest income paid on loans to subsidiaries when that interest was paid into an offshore jurisdiction would be subject to tax, as the CFC rules would catch it by disregarding the offshore company and allocating such income to the U.K. parent. In that sense, according to the Commission, the GFE provided a selective advantage to multinational group companies when compared with other U.K. resident entities that did not operate cross-border and, hence, the GFE was in breach of the EU State aid rules.

It should be noted that the Commission referred in passing to the CFC provisions in the Anti-Tax Avoidance Directive (ATAD) (see VI.B.5., above). It noted that the “minimum standard” for CFC rules laid down in the ATAD did not include anything corresponding to the GFE.

In its decision, the Commission distinguished between “financing with U.K. connected capital” (“U.K. connected capital test”) and “managing the financing activities from the U.K.” (“U.K. activities test”). In the former case, i.e., when financing income from a foreign group company, channeled through an offshore subsidiary, was financed with U.K. connected capital and there were no U.K. activities involved in generating the fi-

¹⁰⁰⁰ <https://eur-lex.europa.eu/eli/dec/2019/1352/oj>.

nance profits, the GFE would be justified and would not constitute State aid under EU rules because such an exemption avoided complex and disproportionately burdensome intra-group tracing exercises that would be required to assess the exact percentage of profits funded with U.K. assets. The Commission therefore acknowledged that the GFE in these cases provided for a clear proxy that was justified to ensure the proper functioning and effectiveness of the CFC rules. In contrast, in the latter case, i.e., when financing income from a foreign group company, channeled through an offshore subsidiary, derived from U.K. activities (i.e., significant people functions in the U.K. had contributed to the generation of the relevant profits), the GFE was not justified and constituted State aid under EU rules because the exercise required to assess to what extent the financing income of a company derived from U.K. activities was not particularly burdensome or complex. Thus, the use of a proxy rule in these cases was not justified. Moreover, the GFE did not seek to address any possible complexity related to the allocation of financing income to U.K. activities.

The Commission therefore concluded that multinationals claiming the GFE while meeting the “U.K. activities test” received an unjustified preferential tax treatment that was illegal under EU State aid rules. [The U.K.’s CFC regime was amended with effect from January 1, 2019, and, hence, as indicated above, the Commission’s Decision only related to the period from January 2013 (when the CFC regime was updated following the *Cadbury Schweppes* decision) to December 2018.]

Appeals against the Commission Decision were lodged before the EU General Court by the United Kingdom (Case T-363/19) and ITV (Case T-456/19) on June 12, 2019 and July 4, 2019 respectively.

(2) Judgment of the EU General Court of June 8, 2022

In its judgment of June 8, 2022, the EU General Court held the special rule (the group financing exemption) for certain financing income included in the CFC regime that applied in the United Kingdom between 2013 and 2018 constituted illegal State aid.¹⁰⁰¹

All seven of the United Kingdom’s and ITV’s pleas to annul the Commission Decision were rejected in their entirety.

According to the EU General Court, the Commission had not made an error in:

- (i) Holding that the rules applicable to CFCs constituted a separate body of tax rules within the general UK corporation tax system; and
- (ii) Adopting those rules as a reference system for the purposes of its analysis.

In particular, the Court noted that the rules applicable to CFCs were based on a logic distinct from that of the general tax system in the United Kingdom.

- This logic was admittedly supplementary or, as the Commission had stated in its decision, a corollary to the general tax system based on the principle of territoriality; however, it was severable from it.

- The United Kingdom’s argument was that the group financing exemption did not give rise to a selective advantage, because, in essence, the rules had to be viewed as a whole, defining the scope of the taxation of the CFC profits and that, hence, the exemption should not have been viewed in isolation from the broader coherent body of rules.

The Court held that the exemptions at issue could not be regarded as a variation in the taxation of CFCs profits. Insofar as those exemptions disregarded the very nature of the rules applicable to CFCs, i.e., the taxation of profits artificially diverted from the United Kingdom, they could not be regarded as being a variation in the application of those rules.

The Court subsequently examined whether the objective of the rules applicable to CFCs was to:

- (i) Protect the UK corporation tax base (as claimed by the United Kingdom and ITV); or
- (ii) Tax profits artificially diverted from the United Kingdom (as argued by the Commission).

According to the Court, these two claims did not represent opposing positions, since the protection of the UK corporation tax base was a broad objective, within which fell the more specific objective of taxing profits artificially diverted from the United Kingdom. The Commission could have therefore validly relied on the protection of the UK corporation tax base, achieved by taxing the profits arising from UK activities and assets artificially diverted from the United Kingdom, as the objective of the CFC rules.

Turning to the selectivity test, the Court held that the Commission had not committed any error of assessment in concluding that there was an advantage in the case at hand and that it was *a priori* selective, since the exemptions at issue derogated from the UK CFC rules, in that they introduced a difference in treatment between taxable companies in a comparable situation, in light of the objective of those rules.

Subsequently, the Court rejected the justifications put forward for the exemptions at issue by the United Kingdom, i.e.:

- (i) Justifications based on reasons of administrative practicability; and
- (ii) Justifications relating to compliance with the freedom of establishment.

In the Court’s opinion, the Commission had not made an error of assessment by failing to demonstrate that multinational groups were encouraged to relocate their finance functions as a result of the exemptions at issue and therefore that trade between Member States was affected by those exemptions.

The Commission was not required to prove actual movements by international groups or to compare the different tax systems within the European Union, provided it was able to demonstrate the existence of an advantage capable of strengthening the competitive position of the beneficiaries of the measure concerned.

Commentators have criticized the EU General Court’s decision on grounds that the Court’s account of the design of the CFC rules was at odds with:

- (i) The United Kingdom’s and ITV’s explanations; and

¹⁰⁰¹ Joined Cases T-363/19, *United Kingdom of Great Britain and Northern Ireland v. the European Commission* and T-456/19, *ITV plc v. the European Commission*.

(ii) The consensus view among practitioners of the risk-based approach of the CFC rules generally, and the group financing exemption in particular.

Appeals were lodged against the judgment of the EU General Court before the CJEU by the United Kingdom and Northern Ireland (Case C-555/22 P) and the ITV (Case C-556/19 P) on August 16 and 17, 2022 respectively.

The applicants' pleas were that:

(i) The General Court erred in law and/or infringed EU law because it distorted the underlying facts and mischaracterized them in law when it concluded that the reference system was the United Kingdom CFC (controlled foreign companies) legislation;

(ii) The General Court erred in law when it held that the United Kingdom CFC legislation gave rise to an advantage;

(iii) The General Court erred in law when assessing the objective and the selectivity of the United Kingdom CFC legislation;

(iv) The General Court erred in law and/or made a manifest error of assessment or appraisal in concluding that the exemptions, if they did confer a selective advantage (*quod non*), could not be justified on the basis of administrative practicability; and

(v) The General Court's reasoning contains a clear error of law as to the requirement of the freedom of establishment and the meaning of the judgment in Case C-196/04, *Cadbury Schweppes and Cadbury Schweppes Overseas*, amounting to a disregard of that case.

At the time of writing, the Advocate General's opinion and the CJEU's judgment are pending.

(3) Judgment of the CFEU of September 19, 2024

In its judgement of September 19, 2024,¹⁰⁰² the CJEU overturned the General Court's decision, thus following the Advocate General's opinion, which had proposed that the CJEU should annul the Commission's decision and set aside the judgement of the General Court.

In his opinion of April 11, 2024, Advocate General Medina was of the opinion that by considering the U.K. CFC regime in isolation from the U.K. corporation tax system as a whole, the Commission (and, subsequently, the General Court) had erred in determining the reference framework for purposes of assessing whether a selective advantage had been conferred. According to the Advocate General, the U.K. CFC rules at issue and the U.K. corporation tax system as a whole had to be read together as they created a consistent body of rules that are not severable from each other.

The CJEU concurred with this analysis. The CJEU reiterated its earlier case law emphasizing the particular importance of determining the reference framework in the case of tax measures, since the existence of an economic advantage for purposes of the State aid rules may be established only when compared with "normal" taxation. It follows, according to the

¹⁰⁰² Joined Cases C-555/22 P, C-556/22 P and C-564/22 P, *UK v Commission and Others*.

Court, that in identifying the correct reference framework, the Commission had to accept the Member State's interpretation of its national law unless it could demonstrate that another interpretation prevailed in either the case law or administrative practice of that Member State. In the absence of any such case law or practice, the Commission's interpretation could only prevail where it was able to demonstrate that the Member State's interpretation was incompatible with the wording of the relevant provisions.

The CJEU concluded that the Commission's analysis, as upheld by the General Court, had failed to establish that the United Kingdom's interpretation of its CFC rules was incompatible with the wording of the relevant provisions. In other words, the Commission had not been able to establish that the United Kingdom's interpretation of the CFC rules and their relationship with the general U.K. corporation tax system was wrong. Accordingly, the CJEU found that the rules applicable to CFCs, taken as a whole and, in particular, as regards non-trading finance profits, supplemented the general U.K. corporation tax system and followed the same logic. That logic is largely based on the principle of territoriality in the sense that the CFC charge was not, or was not fully, applied where the risk of artificial diversion of profits or the erosion of the U.K. corporation tax base was not sufficiently high.

In line with the Advocate General's opinion, the CJEU thus held that the General Court had erred in law in concluding that the reference framework for purposes of examining the selectivity of the CFC exemptions at issue consisted solely of the CFC rules. That error vitiated the Commission's state aid analysis and subsequent conclusions and was sufficient for the CJEU to set aside the General Court's decision in its entirety and annul the Commission's original decision.

Comment: The CFC decision is in line with the *Fiat* decision, but seems at odds with the *Apple* decision (which was adopted only nine days earlier). In its *CFC* decision, the CJEU reiterates (as it had done in *Fiat*) that deference must be put on the fiscal autonomy of a Member State in the area of direct taxation, i.e., when the State defines its own system of taxation – a position from which the CJEU seemed to depart in *Apple* (see above).

3. Open Formal Commission State Aid Investigations

a. Overview

At the time of writing, open formal Commission investigations¹⁰⁰³ concern the following:

(i) The Netherlands (IKEA — opening decision dated December 18, 2017);¹⁰⁰⁴

(ii) The Netherlands (Nike — opening decision dated January 10, 2019);¹⁰⁰⁵ and

¹⁰⁰³ Pursuant to TFEU, Art. 108(2) the Commission is obliged to initiate a formal investigation procedure where, upon a preliminary examination of a State (tax) measure (including tax rulings), such measure could constitute State aid within the meaning of Article 107(1) of the Treaty, which could be incompatible with the internal market.

¹⁰⁰⁴ Press release IP/17/5343; see also State aid Register, case number SA.46470.

¹⁰⁰⁵ Press release IP/19/322; see also State aid Register, case number SA.51284.

(iii) Luxembourg (Huhtalux — opening decision dated March 9, 2019).¹⁰⁰⁶

b. IKEA

¹⁰⁰⁶ Press release IP/19/1591; see also State aid Register, case number SA.50400.



Source: https://ec.europa.eu/commission/presscorner/detail/en/IP_17_5343.

The in-depth investigation concerning IKEA relates to the Dutch tax treatment of Inter IKEA Systems, one of the two groups operating the IKEA business.

The Commission has concerns that two Dutch tax rulings issued in 2006 and 2011 may have allowed Inter IKEA to pay less tax than, and given it an unfair advantage over other companies, in breach of EU State aid rules.

In the early 1980s, the IKEA business model changed into a franchising model.

- Since then, it has been the Inter IKEA group that operates the franchise business of IKEA, using the “IKEA franchise concept” under which all IKEA shops worldwide pay a franchise fee of 3% of their turnover to Inter IKEA Systems, a subsidiary of the Inter IKEA group in the Netherlands.

- In return, the IKEA shops are entitled to use the IKEA trademark and receive know-how allowing them to operate and exploit the IKEA franchise concept.

- On the other hand, Inter IKEA Systems paid an annual license fee to another company in the Inter IKEA group, i.e., I.I. Holding, for the use (under an exclusive license) of certain IP rights required for the creation and development of the IKEA franchise concept. The annual license fee paid by Inter IKEA Systems to I.I. Holding, as endorsed by the

2006 tax ruling, made up a significant part of Inter IKEA Systems’ revenue.

- As a result, a significant part of Inter IKEA Systems’ franchise profits was shifted from Inter IKEA Systems to I.I. Holding in Luxembourg, where they remained untaxed because I.I. Holding was operating under the Luxembourg 1929 holding company tax regime under which it was exempt from corporate taxation in Luxembourg.

In July 2006, the Commission concluded that the Luxembourg 1929 holding company tax regime was illegal under the EU State aid rules and required the scheme to be fully repealed by December 31, 2010. No illegal aid needed to be recovered from I.I. Holding because the scheme was granted under a Luxembourg law of 1929, predating the EC Treaty.

As a result of the Commission decision, I.I. Holding would have had to start paying corporate taxes in Luxembourg from 2011.

In 2011, however, Inter IKEA Systems changed the way it was structured by buying the IP rights formerly held by I.I. Holding.

- To finance this acquisition, Inter IKEA Systems received an intercompany loan from its parent company in Liechtenstein.

- The 2011 tax ruling issued by the Dutch authorities endorsed the price paid by Inter IKEA Systems for the acquisition of the IP.

- The said ruling also endorsed the interest to be paid under the intercompany loan to the parent company in Liechtenstein, and the deduction of the interest payments from Inter IKEA Systems' taxable profits in the Netherlands.

- As a result of the interest payments, a significant part of Inter IKEA Systems' franchise profits after 2011 was shifted to its parent in Liechtenstein.

Within the context of its in-depth investigation, the Commission intends to assess whether the annual license fee paid by Inter IKEA Systems to I.I. Holding, endorsed in the 2006 tax ruling, reflects economic reality.

- In particular, it will assess whether the level of the annual license fee reflects Inter IKEA Systems' contribution to the franchise business.

The Commission will also assess whether the price Inter IKEA Systems agreed for the acquisition of the IP rights and,

consequently, the interest paid on the intercompany loan endorsed in the 2011 tax ruling reflect economic reality.

- In particular, the Commission will assess whether the acquisition price adequately reflects the contribution made by Inter IKEA Systems to the value of the franchise business, and the level of interest deducted from Inter IKEA Systems' tax base in the Netherlands.

The Commission announced on April 30, 2020 that it had widened the scope of its in-depth investigation into the Netherlands' tax treatment of an IKEA subsidiary, Inter IKEA's tax.

The Commission will determine if the Netherlands' annual tax assessments of the Dutch subsidiary tax liability granted the subsidiary State aid.

c. Nike/Converse ("Nike")



Source: https://ec.europa.eu/commission/presscorner/detail/en/IP_19_322.

The in-depth investigation concerning Nike relates to the tax treatment in the Netherlands of two Nike group companies based in the Netherlands:

- Nike European Operations Netherlands BV; and
- Converse Netherlands BV.

These companies develop, market and record the sales of Nike and Converse products in the EMEA region.

Both companies obtained, in return for a tax-deductible royalty payment, licenses to use intellectual property rights relating to, respectively, Nike and Converse products from two other Nike group entities also based in the Netherlands that are transparent for Dutch tax purposes (i.e., not taxable in the Netherlands).

- From 2006 to 2015, the Dutch tax authorities issued five tax rulings, endorsing a method to calculate the royalty to be paid by Nike European Operations Netherlands and Converse Netherlands for the use of the intellectual property.

- As a result of the rulings, Nike European Operations Netherlands BV and Converse Netherlands BV are only taxed in the Netherlands on a limited operating margin based on sales.

The Commission is concerned that the royalty payments endorsed by the rulings may not reflect economic reality in that they appear to be higher than what independent companies negotiating on market terms would have agreed between themselves in accordance with the arm's length principle.

- Specifically, the Commission's investigation will focus on whether the Netherlands' tax rulings endorsing these

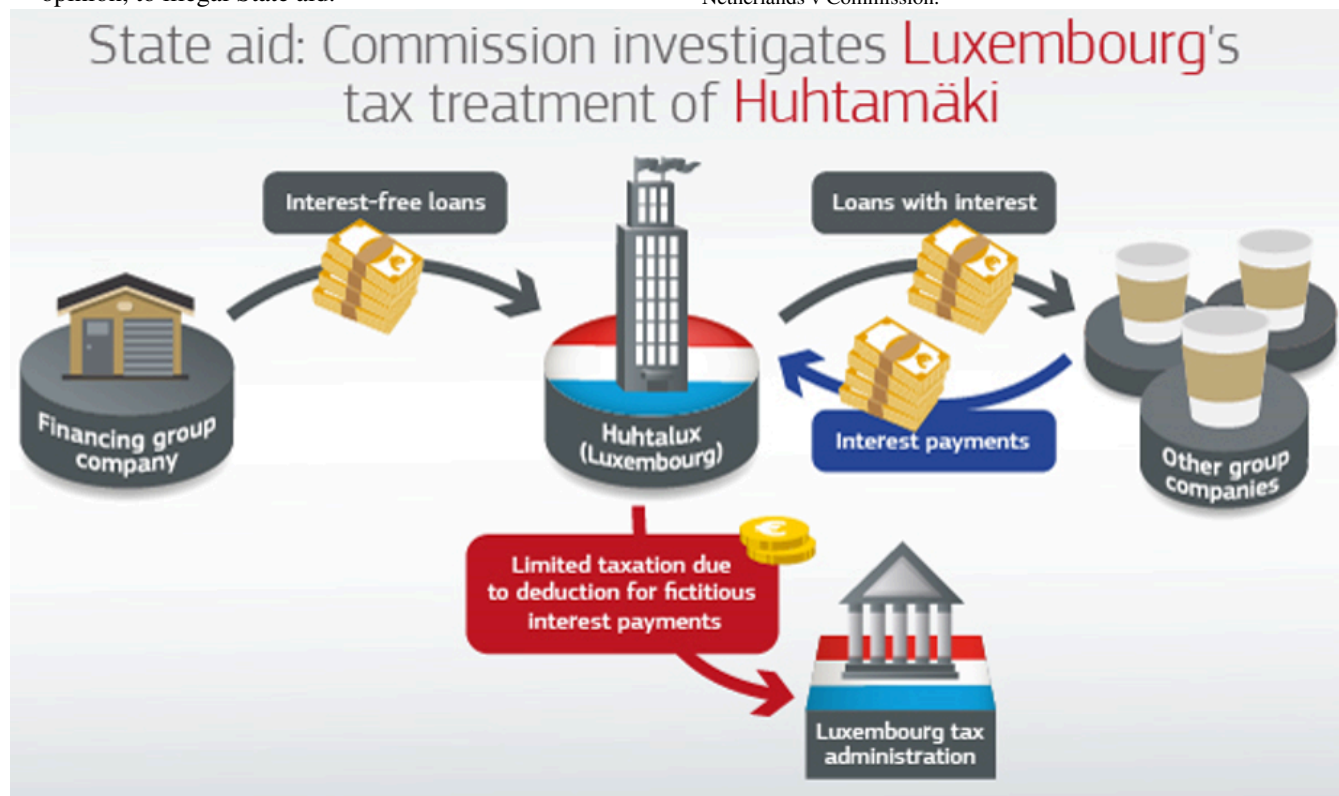
royalty payments may have unduly reduced the taxable base in the Netherlands of Nike European Operations Netherlands BV and Converse Netherlands BV since 2006, the result being, that the Netherlands may have granted a selective advantage to the Nike group by allowing it to pay less tax than other standalone or group companies whose transactions are priced in accordance with market terms.

• If confirmed, this would amount, in the Commission's opinion, to illegal State aid.

Nike's appeal to the EU General Court to halt the Commission's State aid investigation was rejected on July 14, 2021.¹⁰⁰⁷ As such, the saga continues.

d. Huhtamäki ("HUHTALUX")

¹⁰⁰⁷ Case T-648/19, Nike European Operations Netherlands and Converse Netherlands v Commission.



Source: https://ec.europa.eu/commission/presscorner/detail/en/IP_19_1591.

The open formal investigation concerning Huhtamäki relates to tax rulings issued by the Luxembourg tax authorities to Huhtalux S.à r.l. ("Huhtalux"), a Luxembourg company forming part of the Finnish based food and drink packaging group, Huhtamäki, in 2009,¹⁰⁰⁸ 2012 and 2013.

• Huhtalux carried out intragroup financing activities. It had received noninterest-bearing loans from an affiliated company established in Ireland, the proceeds of which Huhtalux on-lent to other affiliated companies under interest-bearing loans.

• In the 2009, 2012 and 2013 rulings, the Luxembourg tax authorities confirmed that, for Luxembourg tax purposes, Huhtalux could deduct a fictitious arm's length rate of interest on the noninterest-bearing loans received from the Irish affiliated company.

• A corresponding upwards tax adjustment in Ireland was not required.

The Commission expressed doubts that this tax treatment, as endorsed in the rulings, could be justified.

• The Commission is concerned that Luxembourg has accepted a unilateral downward adjustment of Huhtalux's taxable base that may grant the company a selective advantage, which would amount to illegal State aid.

• This is because it would allow the group to pay less tax than other standalone or group companies whose transactions are priced in accordance with market terms.

4. US Reaction

Unsurprisingly, the Commission's novel approach to challenging tax rulings — especially those affecting US-based MNEs — under the EU State aid rules has attracted fierce US criticism.

The US Treasury Department issued a White Paper on August 24, 2016, setting out the US government's objections to the Commission's approach to transfer pricing.

The White Paper raises the following concerns:¹⁰⁰⁹

¹⁰⁰⁸ The 2009 ruling was part of a large number of tax rulings disclosed within the scope of the "Luxleaks" investigation led by the International Consortium of Investigative Journalists in 2014.

• “The Commission’s approach is new and departs from prior EU case law and Commission decisions. The Commission has advanced several previously unarticulated theories as to why its Member States’ generally available tax rulings may constitute impermissible State aid in particular cases. Such a change in course, which has required the Commission to second-guess Member State income tax determinations, was an unforeseeable departure from the status quo.”

• “The Commission should not seek retroactive recoveries under its new approach. The Commission is seeking to recover amounts related to tax years prior to the announcement of this new approach — in effect seeking retroactive recoveries. Because the Commission’s approach departs from prior practice, it should not be applied retroactively. Indeed, it would be inconsistent with EU legal principles to do so. Moreover, imposing retroactive recoveries would undermine the G20’s efforts to improve tax certainty and set an undesirable precedent for tax authorities in other countries.”

• “The Commission’s new approach is inconsistent with international norms and undermines the international tax system. The OECD Transfer Pricing Guidelines (“OECD TP Guidelines”) are widely used by tax authorities to ensure consistent application of the “arm’s length principle,” which generally governs transfer pricing determinations. Rather than adhere to the OECD TP Guidelines, the Commission asserts it is employing a different arm’s length principle that is derived from EU treaty law. The Commission’s actions undermine the international consensus on transfer pricing standards, call into question the ability of Member States to honor their bilateral tax treaties, and undermine the progress made under the OECD/G20 Base Erosion and Profit Shifting (BEPS) project.”

Further concerns raised in the White Paper are that:

(i) Member States may be prevented from honoring their obligations under bilateral tax treaties with the United States if the Commission sets out transfer pricing analysis from which they are unable to depart in any mutual agreement procedure; and

(ii) US multinationals may be entitled to claim foreign tax credits with respect to State aid recoveries, which would effectively transfer revenue from the United States to Member States.

¹⁰⁰⁹ See also the earlier concerns repeatedly expressed by Robert Stack, US Treasury Deputy Assistant Secretary for International Tax Affairs, to the effect that the EU Commission appears to be “disproportionately targeting US companies.” In addition, according to Stack, the US government is trying to persuade the EU Commission that it is inappropriate to require EU Member States to recover “retroactive” tax from multinationals on a finding that illegal State aid was provided through overly-generous private tax rulings. Speaking on December 1, 2015, at separate hearings held by the Senate Finance Committee and the House Ways and Means Subcommittee on tax policy, Stack said that it is unfair to impose tax retroactively in the EU State aid cases because the EU Commission is using a novel theory to impose tax that no one expected. Stack also told both Congressional panels that the US Treasury has not yet determined whether amounts recovered from multinationals by the EU States would be considered creditable foreign taxes for US tax purposes. If so, the burden of the State aid recoveries would be borne by US taxpayers, Stack said.

To date, there has been no formal response to the White Paper from the Commission.

On September 15, 2016, the Internal Revenue Service and the Treasury Department proposed, in Notice 2016-52 (the “Notice”), new rules that limit the ability of US multinational groups to claim credits against US taxes for significant foreign tax adjustments (i.e., adjustments of more than \$10 million):

(i) According to the Notice, no inference is intended as to whether payments made pursuant to any particular foreign-initiated adjustment, including those arising under EU State aid law, qualify as payments of creditable foreign income taxes.

(ii) Should EU State aid payments qualify as a general matter, however, the Notice provides that if such payments are preceded by a restructuring of the US taxpayer’s multinational group or by a distribution of the earnings taken into account in calculating the State aid payments so that those earnings are separated from the payments under US tax accounting principles, a credit may be denied under Internal Revenue Code §909 if that separation is considered a “foreign tax credit splitting event.”¹⁰¹⁰

(iii) Because the Notice deals only with foreign income taxes that are added to a foreign subsidiary’s post-1986 “pool” of earnings and profits, and the concept of earnings and profits pools was eliminated in 2017, it would appear that the Notice applies only to foreign income taxes paid by a subsidiary in a taxable year beginning before January 1, 2018. (See generally 6020 T.M., *The Creditability of Foreign Taxes — General Issues*, at VI.D.4.c.)

One commentator has suggested that the US President may invoke Section 891 of the Internal Revenue Code in response to any State aid recovery. Section 891 allows the United States to double certain taxes on citizens and corporations of a foreign country if the President finds that country to have subjected US citizens or corporations to “discriminatory or extraterritorial taxes.”

However, it is unclear whether the State aid recovery obligations would amount to discriminatory or extraterritorial taxes for these purposes.

¹⁰¹⁰ The “splitter” rules are intended to ensure that the taxpayer (or, sometimes more precisely, the foreign subsidiary faced with the State aid liability) repatriates the underlying earnings in order for the credit to be available. However, the Notice and §909 prevent the use of the credit only when, under tax accounting principles, the earnings on which the State aid payment is imposed are separated from the tax payment (i.e., those earnings end up in the earnings account of an entity other than the entity that ends up paying the State aid payment). The “abuse” that is intended to be remedied is allowing the tax paying entity to get full credit for having paid the foreign tax without spreading the credit over the full amount of earnings on which the State Aid payment was based. Without §909, doing so would “supercharge” the tax paying entity’s remaining earnings, i.e., each dollar (or euro) of distributions of those earnings would carry with it a higher foreign tax credit element than is warranted. But, because the US rules pool all post-1986 earnings and pool all post-1986 foreign income taxes of a given entity, the tax paying entity does not actually have to distribute the same underlying earnings on which the State Aid payment was based to avoid §909, so long as those earnings remain in that entity’s undistributed earnings pool.

5. Further Developments

In her keynote speech at the March 2023 Copenhagen State Aid and Tax Conference, Executive Vice-President of the EU Commission Margarethe Vestager referred to the recent court State aid rulings, especially the Fiat case, which, in her opinion, “have brought clarification over how these investigations can be conducted.

With this guidance in hand, [the Commission is] continuing to adapt [its] approach and target aggressive tax planning more effectively.”

She further reported that her “services have conducted an in-depth inquiry into tax ruling practices in all Member States for the period 2014–2018” and expressed the expectation that “this will lead to new investigations in certain countries.

At the same time, work continues on ongoing investigations, for example the Ikea investigation, (...). And there are a number of other important investigations ongoing; with, as I say, the likelihood that more will be launched in the not-so-distant future.”

6. Author's Considerations

The case law of both the EU General Court and the CJEU confirms the Commission's power to evaluate whether tax rulings constitute State aid, which in itself is an imprimatur accorded to the Commission's basic approach.

Technically, as the notion of State aid is objective, i.e., the target is any measure that satisfies the five State aid criteria (economic advantage, selectivity, measure imputable to the State, distortion of competition, and effect on trade between Member States), there is little doubt that it is valid for the Commission to review Member States' tax rulings under the EU State aid rules.¹⁰¹¹

A novelty in these cases, however, is the Commission's investigation of individual tax rulings, rather than tax regimes.

Conceptually, a major concern is that the Commission, in its recovery decisions, is pursuing new theories that, in certain respects, might be inconsistent with international tax standards.

The criticism of practitioners (and other stakeholders) is essentially that the Commission appears to be dismissing widely applied methodologies and standards that are generally regarded as complying with the OECD guidelines.

- Specifically, the arm's-length principle applied by the Commission does not appear to be the arm's-length principle set out in the OECD Transfer Pricing Guidelines, but another *sui generis* arm's-length principle derived directly from the TFEU.
- This “EU arm's-length principle” deviates from the OECD arm's-length principle (Article 9 of the OECD Model Tax Convention).

- As indicated in the State Aid Notice (see above), the arm's-length principle the Commission applies in assessing transfer pricing rulings under the State aid rules is an application of (and finds its source in) Article 107(1) of the TFEU, precisely where this provision prohibits unequal treatment in the taxation of undertakings in a similar factual and legal situation.

- According to the Commission, therefore, the reference system (being the general corporate income tax system) applies to standalone and group companies alike; standalone companies by definition enter into transactions based on arm's-length prices and are therefore also taxed on that basis.

- As a result, it would be a derogation from the general system to allow group companies to be taxed based on non-arm's-length prices.

- Also, the basis given by the Commission for its autonomous arm's-length principle, to the extent that it is questionable, might induce the reviewing EU courts to consider that the Commission is arguably encroaching on the (fiscal) sovereignty of Member States.

The Commission, by its own admission, has casted doubt on the alleged existence of an independent *sui generis* arm's-length principle derived directly from the TFEU — in its Transfer Pricing Proposal, the reference standard is without any doubt the OECD arm's-length principle.

Another (related) concern is that the Commission's recovery decisions seem not to accept that the Member State's own law serves as the reference system and that instead the proper reference system should consist of a normative income tax base and normative transfer-pricing rules.¹⁰¹² This would appear to be in contradiction of the first step of the “derogation test” for establishing “selectivity,” i.e., the need to identify and examine the common or “normal” tax regime applicable “in the Member State concerned” (see XVI.B.3.d., above).

A further concern is that, while the OECD TP Guidelines accept that transfer pricing is not an exact science, the Commission appears to have difficulty in accepting that there may be a range of possible arm's-length results.¹⁰¹³

In sum, it seems doubtful that the State aid rules offer an appropriate instrument for the control of transfer pricing-related tax rulings. There is a certain logic in that assessment in that State aid analysis should in principle look at a (tax) measure of a single State and, hence, appears ill-fitted to address cross-border situations that are at the core of transfer pricing.

Another question is whether the EU courts might annul the Commission recovery decisions on legitimate expectation

¹⁰¹¹ In this respect, it should be borne in mind that State aid investigations are administrative procedures, with the Commission and the Member State concerned as the only parties. It follows that the beneficiary of the alleged aid is treated as a third party: although able to comment on the proceedings, it has no formal role. The recovery decision is addressed to the Member State only. Both the aid beneficiary and the Member State can, and often do, appeal such decisions before the EU courts.

¹⁰¹² For example, in the Apple recovery decision, despite the fact that Ireland claimed it had not incorporated into its law the OECD arm's-length principle (nor any other arm's-length principle) for attributing profits to Irish branches of nonresident companies, the Commission used the OECD Report on the Attribution of Profits to Permanent Establishments (which, moreover, post-dated the contested rulings).

¹⁰¹³ See, e.g., the Fiat final decision, recital (295), in which the Commission cites paragraph 3.57 of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (the “OECD TP Guidelines”), which suggests using the interquartile range to narrow the set of results in appropriate circumstances, as authority for the proposition that Fiat should not have used the interquartile range but rather the median.

grounds, i.e., the argument that the taxpayers concerned legitimately expected that the rulings they received were not illegal State aid, despite the fact that this expectation arose, in part, due to the long-standing inaction of the Commission.

In the author's view, this is rather unlikely given that the interpretation of the legitimate expectations standard by the EU courts is stringent (see XVI.G., below).

D. *De Minimis Aid*

Regulation (EU) 2023/2831 of December 18, 2013 on the application of Articles 107 and 108 of the TFEU to *de minimis* aid, which entered into force on January 1, 2024 and applies until December 31, 2030, covers small amounts of State aid (*de minimis* aid) that:

- (i) Do not constitute State aid in the sense of Article 107(1) of the TFEU; and
- (ii) Are therefore not subject to the notification requirement.

The rule is based on the assumption that, in the vast majority of cases, small amounts of aid do not have an effect on trade and competition between Member States.

Specifically, the *de minimis* rule sets a threshold figure for aid below which Article 107(1) of the TFEU does not apply.

The ceiling for the aid covered by the *de minimis* rule is, in general, 300,000 euros (cash grant equivalent) over any three-year period.

The relevant period of three years has a mobile character, i.e., for each new grant of *de minimis* aid, the total amount of *de minimis* aid granted during three consecutive years (including the then current year) has to be determined.

The ceiling applies to a single undertaking, meaning the enterprise that receives the aid and linked enterprises.

The ceiling applies to all kinds of aid, except aid for: the primary production of fishery, aquaculture and agricultural products; the processing and marketing of fishery, aquaculture and agricultural products where the amount of aid is fixed based on the price or quantity of items purchased or put on sale or additionally, in the case of agricultural products, where the aid is partly or wholly passed on to primary producers; activities related to exports (such as distribution networks) to EU Member States or third countries; and the use of domestic goods and services over imported ones.¹⁰¹⁴

The Regulation applied only to aid with respect to which it was possible to calculate precisely the gross grant equivalent of the aid *ex ante* without any need to undertake a risk assessment (transparent aid).

De minimis aid is deemed granted at the moment the legal right to receive the aid is conferred on the undertaking irrespective of when is actually paid.

The *de minimis* aid scheme is subject to certain monitoring and reporting requirements. Specifically, with effect from January 1, 2026, Member States must record information, such as the amount of aid granted and the beneficiary, in a publicly accessible central national or European register.¹⁰¹⁵ Financial in-

¹⁰¹⁴ Thus, national legislation that excludes investments in assets used for export-related activities from the benefit of tax relief constituting *de minimis* aid is legally permissible (Case C-518, *ZPT AD*).

termediaries administering *de minimis* aid schemes must report on a quarterly basis the total amount of *de minimis* aid they receive. Member States must upload information within 20 working days of the aid being granted and keep that information for 10 years. They must also verify that the 300,000-euro ceiling is not exceeded before approving *de minimis* aid under the Regulation or its predecessor Regulations.¹⁰¹⁶

E. *Exemptions from the Prohibition on State Aid*

Aside from the *de minimis* rule discussed in XVI.D., above (which serves as a quantitative exemption from the prohibition on State aid by excluding tax measures that in fact constitute State aid from the notification and prior authorization procedure of Article 108(3) of the TFEU), the Treaty provides for two categories of qualitative exemptions:

(i) Types of State aid that are automatically, i.e., *ex lege*, considered to be compatible with the internal market (Article 107(2) of the TFEU) (“legal” exemptions); and

(ii) Types of State aid that may be considered compatible with the internal market (Article 107(3) of the TFEU) (“discretionary” exemptions).

The “legal” exemptions include:

(i) Aid having a social character granted to individual consumers, provided the aid is granted without discrimination related to the origin of the products concerned;

(ii) Aid to make good the damage caused by natural disasters or exceptional occurrences; and

(iii) Aid granted to the economy of certain areas of the Federal Republic of Germany affected by the division of Germany (of historical relevance only).

In the tax context, of more relevance are the “discretionary” exemptions (especially categories (i) and (ii)) under which the following may be considered to be compatible with the internal market:

(i) Aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment, and of certain other regions,¹⁰¹⁷ in view of their structural, economic and social situation;

(ii) Aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State;

(iii) Aid to facilitate the development of certain economic activities or certain economic areas, where the aid does not

¹⁰¹⁵ Until the central register is set up and covers a period of three years, a Member State that intends to grant *de minimis* aid to an undertaking in accordance with the Regulation must inform the undertaking in written or electronic form of the amount of the aid expressed as a gross grant equivalent and its *de minimis* character, referring directly to the Regulation.

¹⁰¹⁶ *De minimis* aid granted in accordance with the Regulation may be aggregated with *de minimis* aid granted in accordance with Commission Regulations (EU) No 1408/2013 and (EU) No 717/2014.

¹⁰¹⁷ Notably the regions referred to in TFEU, Art. 349 (i.e., Guadeloupe, French Guiana, Martinique, Réunion, Saint-Barthélemy, Saint-Martin, the Azores, Madeira and the Canary Islands).

adversely affect trading conditions to an extent contrary to the common interest;

(iv) Aid to promote culture and heritage conservation where the aid does not affect trading conditions and competition in the European Union to an extent that is contrary to the common interest; and

(v) Other categories of aid as may be specified by a decision of the Council on a proposal from the Commission.

On a proposal from the Commission and following consultation with the European Parliament, the Council may also determine categories of State aid that are exempted from the notification requirement and, with regard to those categories, the Commission may adopt regulations, i.e., the regulations on the “block exemption” of certain categories of aid.

The current “block exemption” regulation is Commission Regulation (EU) No 651/2014 of June 17, 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty (the “Block Exemption Regulation”), as amended by Commission Regulation (EU) 2023/1315 of June 23, 2023.¹⁰¹⁸

The Block Exemption Regulation (as amended) replaced Commission Regulation (EC) No 800/2008, which expired on June 30, 2014. The current rules are due to be applied until December 31, 2026.

Broadly, the “2014 Block Exemption Regulation” regulates certain tax-related aids, such as:

(i) Council Regulation (EU) No 734/2013 of July 22, 2013; and

(ii) Aid in the form of reductions in environmental taxes (also within the framework of energy products and electricity); and

(iii) Tax incentives granted to private investors in the context of SMEs.

F. Procedural Rules — “Existing” Versus “New” State Aid

Detailed rules are laid down in Council Regulation (EC) No 659/1999 of March 22, 1999, as amended by:

(i) Council Regulation (EU) No 734/2013 of July 22, 2013; and

(ii) Council Regulation (EU) 2015/1589 of July 13, 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union.

Under the procedural rules, a clear distinction is made between “existing” aid and “new” aid as different review systems are applicable to each of them.

1. Existing Aid

Existing aid is aid that was in operation before the establishment of the European Union in 1958 or before the accession date of a new Member State.

Other forms of existing aid are listed in the 1999 Regulation, as amended.

Even where national measures do not constitute State aid at the time that they are introduced, but subsequently become State aid (due to the evolution of the common market), such measures are still deemed to constitute existing aid.

An increase in the revenue of taxes financing several authorized aid schemes in comparison with the projections notified to the Commission constitutes an alteration to existing aid, unless that increase remains under the 20% threshold laid down in the 1999 Regulation.

2. New Aid

New aid is all aid other than existing aid. New aid must be notified to the Commission if it arouses the suspicion of State aid.

The notification has to be made in sufficient time to allow the Commission to comment on the measure before it is implemented — there is a prohibition on the implementation of the notified measure (known as the “direct blocking effect”) for as long as it has not been declared compatible with the common market by the Commission, or is deemed to have been declared compatible (*nihil obstat*). The prohibition on implementation is directly applicable in Member States.

As indicated at XVI.D. and E., above, there are numerous exceptions to the notification requirement.

G. Recovery of Unlawful State Aid

The purpose of recovery is to re-establish the situation that existed in the market prior to the granting of the aid in question. This is necessary to ensure that the level-playing field in the internal market is maintained. In this context, the CJEU has emphasized that the recovery of unlawful and incompatible aid is not a penalty, but the logical consequence of the finding that it is unlawful.

The re-establishment of the previously existing situation is obtained once the unlawful and incompatible aid is repaid by the recipient, which thereby forfeits the advantage that it enjoyed over its competitors in the market and the situation as it existed prior to the granting of the aid is restored.

To eliminate any financial advantages incidental to unlawful aid, interest is to be recovered on the sums unlawfully granted. Such interest (which is to be distinguished from “default” interest, i.e., interest payable by reason of the delayed performance of the obligation to repay the aid) must be equivalent to the financial advantage arising from the availability of the funds in question, free of charge, over a given period.

• In the traditional view of the Commission, in the case of State aid in the form of tax measures, the amount to be recovered is calculated based on a comparison between the tax actually paid and the amount that should have been paid if the generally applicable rule had been applied.

¹⁰¹⁸ Commission Regulation (EU) 2023/1315 of June 23, 2023 amending Regulation (EU) No 651/2014 declaring certain categories of aid compatible with the internal market in application of Arts. 107 and 108 of the Treaty and Regulation (EU) 2022/2473 declaring certain categories of aid to undertakings active in the production, processing and marketing of fishery and aquaculture products compatible with the internal market in application of Treaty, Arts. 107 and 108.

- Interest is added to this basic amount; the interest rate to be applied is equivalent to the reference rate used to calculate the grant equivalent of regional aid.

According to the CJEU, however, the Commission is not in charge of determining the exact amount of tax aid that should be recovered, and should limit itself to providing relevant indications. It belongs to the Member States to determine the exact amount of the tax aid in question.¹⁰¹⁹

Recipients of aid need only refund the net amount of the tax aid, meaning that Member States can deduct certain sums in calculating aid recovery in accordance with their tax system.

However, the application of national law must not affect the scope and effectiveness of EU law, i.e., it must not make it impossible in practice to recover the sums irregularly granted or be discriminatory in relation to comparable cases governed solely by national legislation. As noted above, recipients of unlawful State aid are also obliged to pay interest with respect to the period of unlawfulness.¹⁰²⁰

Recovery of unlawful State aid is not required if it would be contrary to a general principle of law.

The general principles of law most often invoked in this context are:

- (i) The principle of the protection of legitimate expectations;¹⁰²¹ and
- (ii) The principle of legal certainty.¹⁰²²

The CJEU has given a very restrictive interpretation of these principles in the context of State aid recovery.

- For example, undertakings to which aid has been granted may not entertain a legitimate expectation that the aid is lawful unless it has been granted in compliance with the (notification) procedure laid down in Article 108 of the TFEU, since a diligent business operator should normally be able to determine whether that procedure has been followed.¹⁰²³
- However, a delay by the Commission in deciding that an aid is illegal and must be abolished and recovered by a Member State could, in certain circumstances, establish a legitimate expectation on the part of the recipients of that aid, preventing the Commission from requiring that Member State to order the refund of the aid.¹⁰²⁴

A Member State to which a recovery decision is addressed is obliged to execute the decision.¹⁰²⁵

¹⁰¹⁹ Case C-81/10 P, *France Telecom*.

¹⁰²⁰ Case C-199/06, *CELF*.

¹⁰²¹ On the principle of the protection of legitimate expectations, see Case C-24/95, *Alcan*; Case C-5/89, *BUG-Alutechnik*. For an example of a case in which the CJEU recognized the existence of legitimate expectations on the part of the beneficiary, see Case C-223/85, *RSV*. See also Joint Cases C-776/23 P — C-780/23 P, *Commission v. Spain*, in which the CJEU recognized the principle of legal certainty in conjunction with that of the protection of legitimate expectations.

¹⁰²² On the principle of legal certainty, see Case C-372/97, *Italy v. Commission*; Joined cases C-74/00 P and C-75/00 P, *Falck and Acciaierie di Bolzano v. Commission*.

¹⁰²³ Joined Cases C-183/02 P and C-187/02 P, *Demesa and Territorio Histórico de Alava*; Case C-81/10 P, *France Telecom*.

¹⁰²⁴ Case C-298/00, *Italy v. Commission*.

¹⁰²⁵ Case 94/87, *Commission v. Germany*.

The CJEU has recognized only one exception to the obligation for a Member State to implement a recovery decision addressed to it, namely the existence of exceptional circumstances that would make it absolutely impossible for the Member State to execute the decision properly.¹⁰²⁶

According to the CJEU, absolute impossibility cannot, however, be merely supposed. The Member State concerned must demonstrate that it attempted, in good faith, to recover the unlawful aid and must cooperate with the Commission with a view to overcoming the difficulties encountered.¹⁰²⁷ The CJEU interprets the concept of “absolute impossibility” in an extremely restrictive manner.¹⁰²⁸

On July 22, 2019, the EU Commission published a new State aid Recovery Notice.¹⁰²⁹ As with the 2007 Recovery Notice, the new Notice is primarily addressed to the authorities of the Member States in charge of implementing Commission decisions ordering recovery of illegal State aid.

The new Notice also contains specific details for recovery of aid granted through tax measures. It states, for example, that national limitation periods applicable to recovery of tax arrears must be left unapplied if this would impede full recovery of the aid.

- To calculate the amount to be recovered, a Member State may take into account whether the beneficiary has paid taxes on the aid received.
- If that is the case, (i.e., the gross aid does not equal the net aid), the Member State may, in accordance with its national tax rules, take account of such tax payments by recovering only the net amount received by the aid beneficiary.
- By contrast, where a beneficiary of unlawful and incompatible aid has not paid taxes on the aid received (i.e., the gross aid equals the net aid), the beneficiary must pay back the gross amount of aid received.
- In any case, the Member State must ensure that the aid beneficiary will not be able to enjoy a further tax relief by claiming that the reimbursement has reduced his or her taxable income.
- In line with the *Unicredito Italiano* case law,¹⁰³⁰ according to which “re-establishing the *status quo ante* means returning, as far as possible, to the situation which would have prevailed if the operations at issue had been carried out without the tax reduction,” the 2019 Recovery Notice specifies that the Member State must calculate the correct amount of tax that an undertaking should have paid if it had not benefited from the unlawful aid measure.

¹⁰²⁶ Case C-404/00, *Commission v. Spain*.

¹⁰²⁷ Case C-280/95, *Commission v. Italy*.

¹⁰²⁸ See, for a number of “negative” examples: Case C-24/95, *Alcan*; Case C-303/88, *Italy v. Commission*; Case C-52/84, *Commission v. Belgium*; Case C-499/99, *Commission v. Spain*; Case C-280/95, *Commission v. Italy*; Case C-6/97, *Italy v. Commission*; Case C-415/03, *Commission v. Greece*.

¹⁰²⁹ Available at https://ec.europa.eu/competition/state_aid/legislation/recovery_notice_en.pdf. The new Notice replaces the Recovery Notice of 2007 (Notice from the Commission — Towards an effective implementation of Commission decisions ordering Member States to recover unlawful and incompatible State aid, OJ C 272, 15.11.2007, p. 4).

¹⁰³⁰ Case C-148/04.

- This quantification can only be based on the choices actually made in the past, without taking into account any alternative, hypothetical choices which would have been available.
- Only automatically applicable deductions provided for by national and international law, if applicable, or by the recovery decision, can be taken into account.

Example: If a Member State implements a recovery decision by increasing the tax base of the aid beneficiary, other tax reliefs which were already available at the time the initial tax was due could, in principle, still be applied. In that instance, the following conditions relating to the other tax reliefs must be fulfilled:

- (i) They may not lead to any (new) State aid;
- (ii) They should concern all taxpayers in the same way;
- (iii) They must apply by way of a rule that existed at the time the incompatible aid was granted; and
- (iv) The undertakings eligible for the reliefs must benefit from them automatically (i.e., the application of the relief does not require prior authorization from the Member State nor the activation of an option in due time by the taxpayer).

Finally, the confidentiality of tax documents is not a valid justification for not providing the requested evidence in this context. Pursuant to national law, to collect tax amounts (including State aid granted in the form of tax relief), the tax authorities of a Member State may have to carry out internal tax audits prior to the actual recovery.

Such tax audits are acceptable provided that:

- (i) They lead to recovery within the recovery deadline; and
- (ii) The methodology set out in the decision for quantifying the aid to be recovered is followed.

H. State Financial Support Conditional on Absence of Links to Non-Cooperative Jurisdictions

Commission Recommendation of July 14, 2020¹⁰³¹ makes the provision of State financial support to undertakings in the European Union conditional on the absence of links to non-cooperative jurisdictions.

After stating that the diversion of financial aid to tax havens can damage the integrity of Member States' public finances as well as the proper functioning of the EU financial system and the internal market of the European Union, the Recommendation acknowledges that the COVID-19 outbreak prompted unprecedented action at national and EU levels to support Member States' economies and facilitate their recovery. This included State intervention to ensure liquidity and access to finance for undertakings, a considerable part of which was subject to EU State aid rules.

According to the Commission, the volume of financial support, in particular liquidity support, granted to undertakings

during COVID-19, called for an immediate and coordinated action to prevent the misuse of public financing.

Specifically, and beyond just the circumstances arising from COVID-19, the granting of financial support should address:

- (i) The need to tackle tax avoidance and fraud; and
- (ii) The abuse of national and EU budgets at the expense of taxpayers and social security systems.

It is therefore recommended that Member States make their provision of financial support to undertakings in the European Union conditional on the absence of links between those undertakings and jurisdictions that feature on the EU list of non-cooperative jurisdictions for tax purposes (see XXII., below).

For these purposes, "financial support" means any type of financial assistance available to all undertakings or selective measures, including COVID-19 related State aid granted pursuant to the State Aid Temporary Framework.¹⁰³²

According to the Recommendation, where a Member State adopts measures that provide financial support to eligible undertakings in its jurisdiction, it should make the entitlement to such financial support contingent on a number of conditions.

Therefore, the undertakings that receive the financial support should not:

- (i) Be resident for tax purposes in, or incorporated under the laws of, jurisdictions that feature on the EU list of non-cooperative jurisdictions;
- (ii) Be controlled, directly or indirectly, by shareholders in jurisdictions that feature on the EU list of non-cooperative jurisdictions, up to the beneficial owner;
- (iii) Control, directly or indirectly, subsidiaries or have permanent establishments (PEs) in jurisdictions that feature on the EU list of non-cooperative jurisdictions; or
- (iv) Share ownership with undertakings in jurisdictions that feature on the EU list of non-cooperative jurisdictions.

To verify compliance with this rule, Member States should ensure that not only the immediate shareholders but also the ultimate owner and all other undertakings under the same ownership are not tax resident in, or incorporated under the laws of, such a jurisdiction.

¹⁰³² As part of the overall effort of Member States to tackle the effects of the COVID-19 crisis on their economies, the Communication from the Commission of March 19, 2020 set out a Temporary Framework for State aid measures to support the economies of Member States in the context of the COVID-19 outbreak (C (2020) 1863 final)). In the Communication, the Commission enumerates additional temporary State aid measures that the Commission considered compatible under Article 107 (3)(b) of the TFEU, which could be approved very rapidly upon notification by the Member State concerned. Moreover, notification of alternative approaches—both aid schemes and individual measures—remained possible. Under the Communication, potentially eligible State aid could take the form of direct grants, repayable advances, tax advantages, public guarantees on loans, subsidized interest rates for loans, guarantees and loans channeled through credit institutions or other financial institutions, or short-term export credit insurance. To be considered compatible on the basis of Article 107(3)(b) of the TFEU, State aid taking the form of tax advantages had to fulfill a number of cumulative conditions, with specific conditions applying to the agricultural, fisheries and aqua-cultural sectors. Initially, the Communication was applicable from March 19, 2020 until December 31, 2020, but was subsequently extended to June 30, 2022.

¹⁰³¹ C (2020) 4885 final.

The owners of the undertaking that receives financial support may be:

- (i) Legal entities (for example, corporations or partnerships);
- (ii) Legal arrangements (for example, trusts); or
- (iii) Natural persons.

Moreover, for the purposes of determining whether an undertaking may be granted financial support, it should be irrelevant how many tiers of legal entities or legal arrangements may sit between the undertaking established in the Member State that grants the financial support and the entity in a jurisdiction that features on the EU list.

According to the Recommendation, restrictions should also apply where it has been established that a company or its owners have been convicted of serious financial crimes, including:

- (i) Financial fraud;
- (ii) Corruption; and
- (iii) Non-payment of tax or social security obligations.

The Recommendation provides for carve-outs under which Member States may disregard the existence of links to the listed non-cooperative jurisdictions, when:

- (i) The undertaking receiving the support provides evidence that the level of the tax liability in the Member State granting the support over a given period of time (for example, the last three years) is considered adequate when compared to the overall turnover or level of activities of the undertaking, at domestic and group levels, over the same period; or
- (ii) The undertaking makes legally binding commitments to remove its ties to EU listed non-cooperative jurisdictions within a short timeframe, subject to appropriate follow-up and sanctions in the case of non-compliance.

At the same time, the Recommendation emphasizes that it is critical that Member States protect genuine economic activities in listed non-cooperative jurisdictions and guarantee that those economic activities are not inadvertently affected.

Specifically, Member States should disregard the existence of links to the listed non-cooperative jurisdictions where the undertaking concerned:

- (i) Has substantial economic presence (supported by staff, equipment, assets and premises, as evidenced by relevant facts and circumstances); and
- (ii) Performs a substantive economic activity in listed non-cooperative jurisdictions.

For these purposes, Member States should include appropriate exceptions in their laws, to ensure that financial support is not prevented where there is real economic activity.

However, Member States should not apply those exceptions if they are not in a position to verify the accuracy of the information provided. This could be due to the insufficient exchange of information on request with the third country concerned, in particular:

- (i) The absence of a tax treaty allowing exchange of information; or

- (ii) The lack of cooperation on the part of the third country.

To assist Member States in ensuring swift implementation and effective enforcement of the requirements, the Recommendation sets out the following principles:

- (i) To simplify procedures and facilitate access to financial support, Member States could accept self-certification on the part of an applicant as evidence that the applicant is fully compliant with the requirements for receiving the financial support (with this process being complemented by enhanced audits/controls at a later stage, making full use of the tools available to mitigate the risk of non-compliance such as country-by-country reports, the automatic exchange of financial account information, the exchange of information on request or access to beneficial ownership information);
- (ii) Member States should provide for effective, proportionate and dissuasive sanctions to discourage applicants from providing false or inaccurate information, including, as a minimum, the recovery of unduly granted financial support; and
- (iii) Member States should not allow self-certification and should carry out enhanced verifications if the undertaking in question has links to jurisdictions on the EU list of non-cooperative jurisdictions and claims the benefit of a carve-out.

Member States are asked to inform the Commission about any measures taken further to the Recommendation.

While there are grounds to argue that the Recommendation was only to apply in the context of COVID-19, recital (3) of the Recommendation seems to suggest otherwise (“including *beyond* the COVID-19 related circumstances.”)

The fact remains, however, that the impact of the Recommendation is uncertain since, as an instrument of soft law, it is not binding on the Member States, and it is therefore up to the Member States to implement it.

I. Clean Industry Deal

On February 26, 2025, the Commission released a Communication, *The Clean Industrial Deal: A joint roadmap for competitiveness and decarbonization (CID)*, which is designed to support the competitiveness and resilience of EU industry and accelerate decarbonization, with a particular focus on energy-intensive industries and the clean-tech sector.¹⁰³³ The business drivers of the CID are: (i) affordable energy; (ii) lead markets; (iii) financing; (iv) circularity and access to materials; (v) global markets and international partnerships; and (vi) skills. These drivers are to be accommodated by taking actions necessary to ensure a competitive economy, such as cutting red tape and fully exploiting the scale of the Single Market, including via the gradual integration of candidate countries, boosting dig-

¹⁰³³ Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions. *The Clean Industrial Deal: A joint roadmap for competitiveness and decarbonization (COM (2025) 85 final)* — <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52025DC0085>; see also Questions and answers the Clean Industrial Deal (https://ec.europa.eu/commission/presscorner/detail/en/qanda_25_551) and Factsheet: Clean Industrial Deal (https://ec.europa.eu/commission/presscorner/detail/en/fs_25_552).

italization, accelerating the deployment of innovation, promoting quality jobs and better coordinating policies at the EU and national levels.

On June 25, 2025, to complement the CID, the Commission adopted the Clean Industrial Deal State Aid Framework (CISAF). This essentially set out the conditions under which Member States can grant aid for clean energy, industrial decarbonization and clean tech manufacturing.

On July 2, 2025, the CISAF was supplemented by the Commission Recommendation on tax incentives to support the Clean Industrial Deal and in light of the Clean Industrial Deal State Aid Framework (the “CID Recommendation”).¹⁰³⁴ The CID Recommendation embodies the Commission’s recognition that tax incentives are a key instrument in encouraging companies to invest in clean assets and technologies that are strategic for the transition to a decarbonized and circular economy.

The CID Recommendation sets out common principles to guide Member States when introducing tax incentives to contribute to the objectives of the CID, focusing primarily on policy options linked to corporate income tax. To this end, the CID Recommendation suggests two kinds of targeted expenditure-based tax incentives: incentives that can be deducted from the tax base, such as accelerated depreciation (up to immediate expensing); and incentives that can be deducted from tax due, such as tax credits.

Under the CID Recommendation, relief for income taxation purposes in the form of accelerated depreciation, up to full and immediate expensing, would relate to costs incurred in a tax period on the acquisition or leasing of clean technology equipment, as defined under the CISAF. When implementing this recommendation, Member States are encouraged to prioritize the full and immediate depreciation of such costs or their depreciation at the highest rate allowed under national tax laws (the “primary option”), thus providing companies with a cash flow benefit, as well as reducing or removing the negative impact of the corporate income tax burden on investment decisions. Where the primary option is not available, Member States are urged to allow an amount equal to at least 30% of the eligible costs to be expensed in the year of acquisition. Where applicable, accelerated depreciation should be accompanied by appropriate rules allowing the carryforward of losses.

The Commission also recommends that Member States should grant taxpayers flexibility in the form of “discretionary depreciation.” This would allow taxpayers to opt to apply: (i) the standard depreciation rules; (ii) accelerated depreciation on the total depreciable amount of eligible assets; or (iii) accelerated depreciation on only a portion of the total depreciable amount. The Commission has also added a specific recommendation to the effect that Member States should consider making zero-emission vehicles for corporate fleets eligible for accelerated depreciation. Finally, the Commission encourages Member States to provide the most generous form of accelerated depreciation where the acquisition or leasing of the assets concerned contributes to a resilient industrial base.

On the other hand, the CID Recommendation suggests granting tax relief in the form of tax credits that would be available to investment projects that create additional manufacturing capacity for final products, specified major components and critical raw materials. Such tax credits should not exceed 150 million euros per project and the maximum aid intensity (i.e., total aid as a percentage of eligible costs) should be 15% of eligible costs for projects outside assisted areas, with higher limits for projects in specified assisted areas. The tax credit limit for investment projects in certain specified assisted areas should be 200 million euros or 350 million euros per project and the maximum aid intensity should be 20% or 35% of the eligible costs.

The CISAF also allows the aid intensity to be increased in the case of projects undertaken by small and medium-sized enterprises. At the same time, Member States are urged to incentivize, and provide tax relief in the form of a tax credit for, investments that reduce greenhouse gas emissions or improve the energy efficiency of industrial activities, in particular to companies implementing and disclosing corporate transition plans aligned with European climate law. Such tax credits should be compatible with the CISAF, with the aid amount being limited to 200 million euros per project and the aid intensity to 20% to 60%, depending on the type of investment. If the tax credit is not exhausted in the relevant tax year, Member States are encouraged to allow the carryforward of the unutilized tax credit for four years.

Where its national tax system allows, a Member State could also allow taxpayers to set income tax credits against other national taxes due. In the circumstance where the tax credit carryforward is utilized and the tax credit is still not exhausted within four years, the recommendation is that Member States should refund the outstanding amount to the taxpayer at that point (with respect to the provisions regarding qualified refundable tax credits set out in the Pillar Two Directive, see VII., above).

Finally, the CID Recommendation also encourages Member States to consider “enhanced” tax credits, potentially in the form of higher tax credits for investment projects that contribute to resilience policy objectives. Member States should comply with certain design conditions in this respect, i.e., to qualify, an investment project should: (i) lead to the production of a net-zero final product or a specific net-zero major component that currently has a high level of dependency on a single third country; (ii) be recognized as a qualifying strategic project; or (iii) be located in an area designated by a Member State as a net-zero technology acceleration valley.

Member States are invited to inform the Commission of national measures taken to implement the CID Recommendation and on the actual uptake of such measures by taxpayers by December 31, 2025. The effectiveness of tax incentives should be evaluated regularly. The Commission will facilitate best practice exchanges, monitor and report on how tax incentives promote clean investment and support the CID’s goal of enhancing the effectiveness of the tax incentives.

As a recommendation issued under Article 292 of the TFEU, the CID Recommendation is not binding on Member States. It will therefore be up to the Member States to consider the adoption of tax incentives to support the CID’s ambitions.

¹⁰³⁴ https://commission.europa.eu/document/download/f4718f39-19cc-42a4-9a9f-48acb824dc4f_en?filename=C_2025_4319_1_EN_ACT_part1_v6.pdf.

J. Clean Industrial Deal State Aid Framework

On February 26, 2025, the Commission released *The Clean Industrial Deal: A joint roadmap for competitiveness and decarbonization* (the CID). The CIT is aimed at supporting the competitiveness and resilience of EU industry and accelerating decarbonization, with a particular focus on energy-intensive industries and the clean-tech sector.¹⁰³⁵ The business drivers of the CID are affordable energy, lead markets, financing, circularity and access to materials, global markets and international partnerships and skills. These business drivers are to be accompanied by actions on horizontal enablers necessary for a competitive economy such as cutting red tape, exploiting the scale of the Single Market including through the gradual integration of candidate countries, boosting digitalization, accelerating the deployment of innovation, promoting quality jobs and better coordinating policies at the EU and national levels.

To complement the CID, on June 25, 2025, the Commission adopted the Clean Industrial Deal State Aid Framework (CISAF). The CISAF essentially set out the conditions under which Member States can grant aid for clean energy, industrial decarbonization and clean tech manufacturing.¹⁰³⁶ The CISAF itself was supplemented on July 2, 2025 by a Commission Recommendation on tax incentives to support the CID and in light of the CISAF (see the discussion at XVI.I., above).¹⁰³⁷

¹⁰³⁵ Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions. *The Clean Industrial Deal: A joint roadmap for competitiveness and decarbonization* (COM (2025) 85 final) — <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52025DC0085>; see also Questions and answers the Clean Industrial Deal (https://ec.europa.eu/commission/presscorner/detail/en/qanda_25_551) and Factsheet: Clean Industrial Deal (https://ec.europa.eu/commission/presscorner/detail/en/fs_25_552).

¹⁰³⁶ Communication from the Commission — Framework for State Aid measures to support the Clean Industrial Deal (Clean Industrial Deal State Aid Framework) (C/2025/7600), OJ C, C/2025/3602, July 4, 2025; <https://eur-lex.europa.eu/eli/C/2025/3602/oj>.

¹⁰³⁷ Although it does not include tax recommendations, the CISAF encourages the use of non-selective tax incentives, e.g., accelerated depreciation. Ad-

The CISAF simplifies the State aid rules in five main areas: (i) the roll-out of renewable energy and low-carbon fuels; (ii) temporary electricity price relief for energy-intensive users to ensure the transition to low-cost clean electricity; (iii) the decarbonization of existing production facilities; (iv) the development of clean tech manufacturing capacity in the European Union; and (v) the de-risking of investments in clean energy, decarbonization, clean tech and energy infrastructure projects, and projects supporting the circular economy.

Specifically, the CISAF introduces:

(i) A “fast-track” for the roll-out of clean energy i.e., renewable energy and low-carbon fuels (such as blue and green hydrogen);

(ii) New rules on flexibility measures and “target-model” capacity mechanisms, giving Member States additional tools to integrate intermittent renewable electricity sources (i.e., wind and solar power) into the energy supply, while ensuring consumers benefit from a reliable supply of electricity;

(iii) Electricity cost support for energy-intensive users, i.e., companies operating in sectors particularly exposed to international trade and heavily dependent on electricity for their production and;

(iv) Flexible support for investments in all technologies leading to decarbonization or increased energy efficiency.

The CISAF is in force as of the date of its publication and will remain in force until December 31, 2030, with the aim of offering businesses and Member States greater predictability around the granting of aid for clean energy, industrial decarbonization and clean tech manufacturing.

ditionally, selective tax advantages must comply with State Aid rules and be notified. As in the case of all forms of aid under the relevant rules, transparency rules require Member States to publicly disclose aid exceeding 100,000 euros within one year of the relevant tax filing. Member States are also encouraged to consider tax solidarity factors and may exclude from State Aid measures entities that use tax havens for tax purposes.

XVII. Value Added Tax

A. Subject Matter and Scope

Executive Summary

This Section is dedicated to a general discussion of the EU common VAT system. The discussion largely follows the structure of Directive 2006/112 of November 28, 2006 on the Common System of Value Added Tax (the “VAT Directive” or VATD). After a number of introductory remarks (XVII.A., below), the discussion first focuses on: (i) the territorial application of the VATD (XVII.B., below); (ii) the concept of taxable persons (including the concept of “economic activity” and the “for consideration” requirement, the VAT status of holding companies, unlawful transactions and abusive transactions, VAT groupings, and public bodies) (XVII.C., below); (iii) taxable transactions; and (iv) the place of taxable transactions, distinguishing between the supply of goods (including a discussion of the extension to distance sales and call-off stock arrangements, composite supplies and vouchers), intra-EU acquisitions, the supply of services (including a discussion of the “deemed supplier rule and online platforms and chain transactions) and the importation of goods) (XVII.D. and XVII.E., below).

The Section continues with a discussion of the chargeable event and the chargeability of VAT (XVII.F., below), the taxable amount (XVII.G., below), the VAT rates (standard and reduced VAT rates) (XVII.H., below), and the VAT exemptions (distinguishing between exemptions carrying a right to deduct and those not carrying a right to deduct) (XVII.I., below) and deductions (with special attention paid to the “direct and immediate link” requirement, the special case of holding companies and the rules governing the exercise of the right to deduct) (XVII.J., below).

The discussion then shifts to the obligations of taxable persons and certain non-taxable persons (the obligation to pay, the reverse charge mechanism, payment arrangements, identification, invoicing, accounting, VAT returns and recapitulative statements) (XVII.K., below). The Section continues with a discussion of “Special Schemes” (small enterprises; farmers; travel agents; second-hand goods, works of art, collectors’ items and antiques; investment gold; and non-established persons supplying electronic services to non-taxable persons) (XVII.L., below). This is followed by a summary discussion of VAT cross-border rulings (XVII.M., below).

The Section then addresses administrative cooperation in the field of VAT (XVII.N., below), followed by a discussion of the VAT in the Digital Age (ViDA) package that was adopted by the EU Council on March 11, 2025 (XVII.O., below).

The Section ends with a discussion of the future prospects of VAT (towards a definitive VAT system) (XVII.P., below). Throughout the Section, extensive reference is made to CJEU case law, which has greatly contributed to the interpretation, correct application and clarification of the common VAT system.

Attributed to one of two sources (the German businessman Wilhelm von Siemens in 1918 or the American economist Thomas S. Adams in his writings between 1910 and 1921), value added tax (VAT) has existed in some form in France, where it was adopted in its modern version in April 1954, since 1948. At that time, VAT was regarded as merely another tax on turnover or consumption and did not attract the attention of other countries. It has only been since 1962, when two reports ordered by the European Commission recommending its adop-

tion by all Member States were published, that its interest to the European Union has been understood. Acting on the basis of Commission proposals, on April 11, 1967, the Council adopted the first Directives on the harmonization of the legislation of Member States concerning turnover taxes (i.e., Directive 67/227 and Directive 67/228). In 2006, the original directives were repealed and replaced by a single directive on the common system of value added tax, i.e., Directive 2006/112 of November 28, 2006 on the Common System of Value Added Tax (the “VAT Directive” or VATD).

As part of the *acquis communautaire*,¹⁰³⁸ VAT is now imposed in the entire internal market of 27 Member States, globally affecting over 500 million citizens. It raises approximately 1,000 billion euros per annum and is one of the most important sources of State revenue in Europe.

The principle of the common system of VAT entails the application to goods and services of a general tax on consumption exactly proportional to the price of the goods and services, however many transactions take place in the production and distribution process before the stage at which the tax is charged. VAT, calculated on the price of the goods or services concerned at the applicable rate, is chargeable on each transaction, after deduction of the amount of VAT borne directly by the various cost components. The common system of VAT is applied up to and including the retail trade stage. The tax is levied at each stage of an economic activity on the value added at the stage concerned. It is paid by all those involved in the production and distribution of a product or service but is not an element in the costs of those intermediaries and does not appear as an item of expenditure in their accounts, as it is not they that bear the tax but the end consumer.

As indicated, the tax is proportional to the price of products and services irrespective of the number of transactions that have taken place at the stages preceding that to which it is applied. At the time of each transaction, the amount of VAT, calculated on the price of the good or service concerned, is reduced by the amount of the taxes previously paid on the cost of the various components of the cost price. The total sum that changes hands at each stage in the production or distribution chain includes the VAT paid up to that point, but the amount of the tax is recovered on each sale, except on the final sale to the final consumer who purchases the product or service for his or her private use. The tax is paid to the State by the vendor in each transaction. However, the vendor does not bear the burden of the VAT, as it has been advanced the full amount of the VAT by the purchaser. Tax paid at previous stages, on deliveries made or services rendered to a taxable person, and the tax paid on imports, is deductible from the turnover tax of that taxable person. Given this deductibility of taxes already paid, VAT is neutral from the point of view of domestic competition, i.e., it does not favor vertically integrated undertakings (as

¹⁰³⁸ The *acquis communautaire* is the body of common rights and obligations that is binding on all the EU Member States. It is constantly evolving and comprises: the content, principles and political objectives of the EU Treaties; legislation adopted pursuant to the EU Treaties and the case law of the Court of Justice; declarations and resolutions adopted by the European Union; instruments under the Common Foreign and Security Policy; international agreements concluded by the European Union and agreements entered into by the Member States among themselves within the sphere of the European Union’s activities.

did the cumulative multi-stage taxes). It is also neutral from the point of view of international competition, since it cannot put domestic products at an advantage. Finally, consideration of economic realities is a fundamental criterion for the application of the common system of VAT.¹⁰³⁹

The VATD establishes a package of common rules making it possible to define the scope of the tax and the method of determining tax liability, i.e., the territorial application of the tax, the taxable persons, the taxable transactions, the place of applicability of such transactions, the chargeable event, the taxable amount, the detailed procedures for applying rates of taxation, the exemptions and the special schemes. This body of rules is generally known as “the uniform basis of assessment of VAT.” With the aim of making the application of the current VAT system more uniform and improving the functioning of the internal market guidelines, an implementing Regulation of March 15, 2011 sets out important aspects of the VATD (i.e., Regulation 282/2011, as amended from time to time) (the “VAT Implementing Regulation”).

Without prejudice to other provisions of Community law, the VATD does not prevent a Member State from maintaining or introducing taxes on insurance contracts, taxes on betting and gambling, excise duties, stamp duties or, more generally, any taxes, duties or charges that cannot be characterized as turnover taxes, provided the collecting of such taxes, duties or charges does not give rise, in trade between Member States, to formalities connected with the crossing of frontiers.¹⁰⁴⁰

It is important to note that the VATD was designed (and intended) to be a transitional system, applying essentially an origin-based taxation regime. In 2017 and 2018, the Commission launched a legislative proposal for a simpler, fraud-proof definitive VAT system as indicated in its 2016 Action Plan on VAT. The proposal would purportedly entail a shift to the country-of-destination principle. Specifically, the Proposal of October 4, 2017 for a Council Directive amending Directive 2006/112/EC as regards harmonizing and simplifying certain rules in the value added tax system and introducing the definitive system for the taxation of trade between Member States was followed by the Proposal of May 25, 2018 for a Council Directive amending Directive 2006/112/EC as regards the introduction of the detailed technical measures for the operation of the definitive VAT system for the taxation of trade between Member States).¹⁰⁴¹ The 2018 Proposal is still pending, but re-

sulted, *inter alia*, in the adoption of “quick fixes,” which the EU VAT Forum¹⁰⁴² described as “a significant step towards the definitive EU VAT regime.”¹⁰⁴³ See also the discussion at XVII.P., below.

Within the framework of the EU VAT Forum, a number of Member States have agreed to participate in a test case for private VAT ruling requests relating to cross-border situations (CBR). Currently, the following Member States participate in this project: Belgium, Cyprus, Denmark, Estonia, Finland, France, Hungary, Ireland, Italy, Latvia, Lithuania, Malta, Netherlands, Poland, Portugal, Slovenia, Spain and Sweden. Taxable persons planning cross-border transactions involving one or more of these participating Member States may wish to ask for such a ruling with regard to the planned transactions.¹⁰⁴⁴

As discussed in further detail below, under the VATD, the following transactions are subject to VAT: (i) the supply of goods for consideration within the territory of a Member State by a taxable person acting as such; (ii) the intra-EU acquisition of goods for consideration within the territory of a Member State by a taxable person or a nontaxable (legal) person; (iii) the supply of services for consideration within the territory of a Member State by a taxable person acting as such; and (iv) the importation of goods.¹⁰⁴⁵ See also XVII.P., below.

B. Territorial Scope

The territorial scope of the common VAT system encompasses the territories of the Member States of the European Union to which the TFEU applies.¹⁰⁴⁶ The territory of a Member State corresponds to the scope of the Treaty as defined for each Member State by Article 355 of the TFEU. In the absence of a more precise definition in the Treaty of the territory falling

it would within a single country had already been made. The need to abolish the fiscal frontiers between Member States by the end of 1992 made it necessary to reconsider the way in which trade in goods was taxed in the European Union. The goal was that goods would be taxed in the country of origin, so that the same conditions that apply to domestic trade would also apply to intra-EU trade, reflecting the idea of a genuine internal market. Since the political and technical conditions were not ripe for such a system, transitional VAT arrangements were adopted. See the discussion at XVII.P.

¹⁰⁴² Commission Decision 2012/C 198/05 of July 3, 2012 established the Commission expert group, the “EU VAT Forum.” The tasks of that expert group were to provide a platform for dialogue between Member States’ tax authorities and business experts or tax practitioners on the practical aspects of administering VAT and to assist the EU Commission in promoting good practice in administering VAT. Commission Decision C (2022) 7947 of November 10, 2022 dissolved the EU VAT Forum. The tasks of the EU VAT Forum were taken over by the “VAT Expert Group” established by Commission Decision 2012/C 188/02 of June 26, 2012 and the “Group on the future of VAT” established by the Directorate-General for Taxation and Customs Union of the Commission on February 24, 2011. The VAT Expert Group, which is composed of private organizations and individuals with competence in the area of VAT policy and its implementation, advises the Commission on VAT policy, especially on the preparation of legislative acts and provides insights on the practical implementation of the policy. The Group on the future of VAT, which is composed of representatives of Member States’ tax authorities, is an informal Commission expert group that is to provide a forum for discussion with Member States’ experts on future VAT legislation and other VAT policy initiatives.

¹⁰⁴³ EU VAT FORUM, Subgroup — “The VAT Quick Fixes”, Ref. ARES (2022) 6620386, September 26, 2022: <https://taxation-customs.ec.europa.eu/system/files/2022-09/EU%20VAT%20FORUM%20-%20THE%20VAT%20QUICK%20FIXES%20%28Final%20incl.%20annexes%29.pdf>.

¹⁰⁴⁴ See XVII.M.

¹⁰⁴⁵ VATD, Art. 2.

¹⁰⁴⁶ VATD, Art. 5.

¹⁰³⁹ See, first, as regards the meaning of place of business for purposes of VAT, Case C-260/95, *DFDS* and Case C-73/06, *Planzer Luxembourg*; and, second, as regards the identification of the person to whom goods are supplied, by analogy, Case C-185/01, *Auto Lease Holland*.

¹⁰⁴⁰ Directive 2006/112 of November 28, 2006, as last amended by Directive 2013/43 (the “Common VAT System Directive” or VATD), Art. 401. This provision has resulted in an abundant body of case law, in particular as regards the question of when and in what circumstances taxes, duties or charges can be characterized as turnover taxes — see, e.g., Case 252/86, *Bergandi*; Joined Cases 93/88 and 94/88, *Wisselink*; Case C-200/90, *Denkavit*; Case C-475/03, *Banco Popolare di Cremona*; Case C-440/12, *Metropol Spielstätten*. By Order of October 12, 2017, the CJEU indicated that VATD, Art. 401 does not preclude the application of a proportional registration duty payable on lease agreements for commercial property, even where such agreements are also subject to VAT (Case C-549/16, *Palais Kaiserhorn*).

¹⁰⁴¹ COM (2017) 569 final 2017/0251 (CNS) and COM (2018) 329 final 2018/0164 (CNS), respectively. The initiative introducing a definitive VAT system is all but new. As long ago as 1967, a commitment to establish a definitive VAT system operating within the European Union in the same way as

within the sovereignty of each Member State, it is for each Member State to determine the extent and limits of that territory, in accordance with the rules of international public law.¹⁰⁴⁷

Certain territories and countries are expressly excluded from the territorial scope of the common system of VAT, i.e.: on the one hand, Mount Athos, the Canary Islands, the French overseas departments, the Åland Islands, the Channel Islands, Campione d'Italia, and the Italian waters of Lake Lugano (territories that form part of the customs territory of the European Union); and, on the other, the Island of Heligoland, the territory of Büsingen, Ceuta, Melilla and Livigno (territories that do not form part of the customs territory of the European Union).¹⁰⁴⁸

Transactions originating in or intended for the Principality of Monaco or the United Kingdom Sovereign Base Areas of Akrotiri and Dhekelia are treated as transactions originating in or intended for France or Cyprus, respectively.¹⁰⁴⁹ Since Brexit, Northern Ireland has been treated as territory of the European Union (for purposes of goods only). If the Commission considers that these exclusions or treatments are no longer justified, particularly in terms of fair competition or own resources, it must present appropriate proposals to the Council.¹⁰⁵⁰

It follows from the above that, in principle, the territorial scope of the common system of VAT coincides, in the case of each Member State, with the scope of its VAT legislation, it being expressly understood that the rules forming part of the common system of VAT have binding and mandatory force throughout the national territory of the Member States.¹⁰⁵¹ Beyond that, however, the VATD in no way restricts the freedom of the Member States to extend the scope of their tax legislation beyond their strict territorial limits, provided they do not encroach on the jurisdiction of other States¹⁰⁵² and provided they observe the common rules laid down by the VATD.¹⁰⁵³

C. Personal Scope: “Taxable Person”

1. General

Under the common system, a “taxable person” means any person that, independently, carries out in any place any economic activity, whatever the purpose or result of that activity.¹⁰⁵⁴ The concept of “taxable person” is broadly interpreted, thus conferring a very wide scope on VAT, comprising all stages of production, distribution and the provision of services.¹⁰⁵⁵ The concept must be given an autonomous and uniform interpretation throughout the European Union to prevent

differences from one Member State to another in the way the VAT system is applied.¹⁰⁵⁶

A natural person who has concluded with another natural person a joint activity agreement setting up a partnership that lacks legal personality and is characterized by the fact that the first person is empowered to act in the name of the partners as a whole, but participates alone and in his or her own name in relations with third parties when performing acts that form the economic activity pursued by that partnership, must be regarded as a “taxable person” and as having sole liability for the VAT payable.¹⁰⁵⁷

2. “Economic Activity”

a. General

An “economic activity” is any activity of producers, traders or persons supplying services, including mining and agricultural activities and activities of the professions. The exploitation of tangible or intangible property for purposes of obtaining income from the property on a continuing basis is also regarded as an economic activity.

The term “economic activity” is very wide in scope and, in the sense that the activity is considered *per se* and without regard to its purpose or result, objective in character.¹⁰⁵⁸

b. Commencement of Economic Activity

A crucial question is when an “economic activity” is deemed to commence. To ensure the overall neutrality of the common system, this should obviously be as soon as possible in the process as it has a direct impact on the taxable person’s ability to deduct input VAT. The question was addressed in *Rompelman*,¹⁰⁵⁹ which concerned an economic activity consisting of the letting of immovable property, in which the Court of Justice of the European Union (CJEU) held that preparatory acts, such as the acquisition of assets and, therefore, the purchase of immovable property that forms part of a letting activity, must themselves be treated as constituting economic activity. The reason is that the principle that VAT should be neutral as regards the tax burden on a business requires that the first investment expenditure incurred for purposes of, and with a view to, commencing a business must be regarded as an economic activity. It would be contrary to that principle if such activity did not commence until the property was actually exploited, that is to say until it began to yield taxable income. Any other interpretation would burden the trader with the cost of VAT in the course of its economic activity without allowing it to deduct it. It would also create an arbitrary distinction between investment expenditure incurred before the actual exploitation of immovable property and expenditure incurred during such exploitation. As supplies of goods or services must be generated for preparatory acts to be treated as an economic activity, there should be a declared intention on the part of the person

¹⁰⁴⁷ Case C-111/05, *Aktiebolaget NN*: “The national territory of the Member States within the meaning of Art. 299 EC [now: Art. 355 TFEU] thus also consists of the territorial sea, its bed and subsoil, it being understood that it is for each Member State to establish the breadth of its territorial sea up to a limit not exceeding 12 nautical miles in accordance with Art. 3 of the Convention on the Law of the Sea.”

¹⁰⁴⁸ VATD, Art. 6.

¹⁰⁴⁹ VATD, Art. 7.

¹⁰⁵⁰ VATD, Art. 8.

¹⁰⁵¹ Case 168/84, *Berkholz* (concerning the operation of gaming machines on board a vessel on the high seas).

¹⁰⁵² Case 283/84, *Trans Tirreno Express SpA*.

¹⁰⁵³ Case C-30/89, *Commission v. France*.

¹⁰⁵⁴ VATD, Art. 9(1).

¹⁰⁵⁵ See Case C-186/89, *van Tiem*. The statement was made with reference to the earlier cases C-235/85, *Commission v. Netherlands* and C-348/87, *Stichting Uitvoering Financiële Acties v. Staatssecretaris van Financiën*, and

has been frequently repeated in later cases such as C-80/95, *Hamas and Helm* and C-60/90, *Polysar*.

¹⁰⁵⁶ Case C-25/03, *Hans U. Hundt-Esswein*.

¹⁰⁵⁷ Case C-312/19, *XT*.

¹⁰⁵⁸ Case 235/85, *Commission v. Netherlands*; Case 268/83, *Rompelman*; Case C-497/01, *Zita Modes*.

¹⁰⁵⁹ Case C-268/83, *Rompelman*.

carrying out such acts to engage in an activity subject to VAT, even if it is ultimately decided not to move to the operational phase (but, in the case concerned, to put the company into liquidation) with the result that the economic activity envisaged does not give rise to taxable transactions.¹⁰⁶⁰

In the same vein, in *Ryanair*,¹⁰⁶¹ the CJEU confirmed that VAT on professional advisor fees paid on an abortive takeover is deductible, provided the buyer intended to supply management services for consideration to the target company. This is further confirmed in Case C-42/19, *Sonaecom*, which concerned the deductibility of input VAT paid with respect to expenditure relating to consultancy services connected with a market study commissioned with a view to possible acquisitions of shareholdings in other companies, where the acquisition(s) did not materialize.¹⁰⁶²

As such, input VAT deducted based on the intention to perform economic activities subject to VAT has to be paid back when this intention ceases to exist.¹⁰⁶³

c. Holding Companies

In *Marle Participations*,¹⁰⁶⁴ it was held that the phrase “involvement of a holding company in the management of its subsidiary” must be understood to cover all transactions constituting an economic activity, within the meaning of the VAT Directive, performed by a holding company for the benefit of its subsidiary. In the case at issue, the (only) services that Marle Participations supplied to the subsidiaries with respect to which it incurred expenditure for the purpose of acquiring their securities, or that it sought to develop with respect to those subsidiaries, related to the letting of a building used by an operational subsidiary as a new production site.

An activity consisting merely of holding bonds or shares does not constitute an economic activity. In *Polysar*, a case concerning a holding company that solely held shares in subsidiary companies, the CJEU held that the mere acquisition and holding of shares in a company is not to be regarded as an economic activity and that Polysar therefore was not a taxable person.¹⁰⁶⁵ Two years later, in *Sofitam*, the CJEU made it clear that the reason for the decision was that the mere acquisition of financial holdings in other undertakings does not amount to the exploitation of property for purposes of obtaining income from the property on a continuing basis because any dividend yielded by those holdings is merely the result of ownership of the property.¹⁰⁶⁶ In *Floridienne and Berginvest*, the CJEU further held that, in view of the fact that the amount of a dividend depends partly on unknown factors and that entitlement to a dividend is merely a function of shareholding, the direct link between a dividend and a supply of services (even where the

services are supplied by a shareholder that is paid dividends), which is necessary if the dividends are to constitute consideration for the services, does not exist.¹⁰⁶⁷ In the same vein, in *Harnas & Helm*, the acquisition of the ownership of, and the holding of, bonds were held not to amount to an economic activity because the income from the bonds derives from the mere fact of holding them, which entitles the holder to payments of interest; such interest cannot be regarded as a return on an economic activity or transaction carried out by the bondholder, since it derives from the mere ownership of the bonds.¹⁰⁶⁸

However, the analysis may be different where the holding of shares is accompanied by direct or indirect involvement in the management of the company in which the holding was acquired, without prejudice to the rights held by the holding company as shareholder. In such circumstances, there is not merely a pure capital investment — the additional element of activity, such as the supply by a holding company to its subsidiaries of administrative, financial, commercial and technical services, confers on it the character of an economic activity.¹⁰⁶⁹ Likewise, the disposal of the totality of the shares that a parent company holds in the share capital of a subsidiary and in that of a controlled company, in the management of which the parent company has directly or indirectly taken part by providing to them for consideration various supplies of services of an administrative, accounting and commercial nature for which that parent is liable for VAT, constitutes an economic activity.¹⁰⁷⁰ In *Sonaecom*,¹⁰⁷¹ the CJEU held that a mixed holding company that carried out preparatory acts that were part of a proposed acquisition of shares in another company to which the holding company planned to provide management services subject to VAT must, on that basis, be considered to pursue an economic activity and, hence, must be considered a taxable person.

In contrast, however, in the case of a holding company carrying on an economic activity consisting of providing management services to its sub-subsidiary whose shares (together with those of the intermediate subsidiary) had been the subject of an abortive sale, the CJEU held (in *C&D Foods Acquisition*)¹⁰⁷² that a share disposal transaction, envisaged but not carried out, for which the direct and exclusive reason does not lie in the taxable economic activity of the company concerned, or that does not constitute the direct, permanent and necessary extension of that economic activity, does not come within the scope of VAT. In the same vein, the involvement of a holding company in the management of its subsidiaries, where it has not charged those subsidiaries for the cost of the services procured in the interests of the group as a whole or in the interest of certain of the holding company's subsidiaries, or for the corresponding VAT, does not constitute an “economic activity.”¹⁰⁷³

¹⁰⁶⁰ Case C-110/94, *INZO*.

¹⁰⁶¹ Case C-249/17, *Ryanair*. The position seems to be different, however, in the case of an abortive sale by a holding company, see Case C-502/17, *C&D Foods Acquisition*, below.

¹⁰⁶² Case C-42/19, *Sonaecom*.

¹⁰⁶³ Case C-293/21, *UAB Vittamed technologijos*.

¹⁰⁶⁴ Case C-320/17, *Marle Participations*.

¹⁰⁶⁵ Case C-60/90, *Polysar*.

¹⁰⁶⁶ Case C-333/91, *Sofitam*; see also Case C-155/94, *Wellcome Trust*, in which the CJEU arrived at a similar conclusion with respect to a trustee purchasing and selling shares and other securities in the course of managing the assets of a charitable trust.

¹⁰⁶⁷ Case C-142/99, *Floridienne and Berginvest*.

¹⁰⁶⁸ Case C-80/95 *Harnas & Helm*.

¹⁰⁶⁹ Case C-16/00, *Cibo Participations*. See also Joined Cases C-108/14 and C-109/14, *Larentia + Minerva and Marenave* (where a holding company actively manages all of its subsidiaries involving the provision of administrative, financial, commercial or technical services, it must be considered to be engaged in an “economic activity”).

¹⁰⁷⁰ Case C-29/08 *Skatteverket v. AB SKF*.

¹⁰⁷¹ Case C-42/19, *Sonaecom*.

¹⁰⁷² Case C-502/17, *C&D Foods Acquisition*.

¹⁰⁷³ See Case C-28/16, *MVM* (Order of the Court).

See also the discussion at XVII.J.1.d., below (the right to deduct).

d. Luxembourg Mutual Funds

A Luxembourg mutual fund (SICAV) engaged in transactions carried out in the course of trading in securities aimed at producing income on a continuing basis on behalf of its subscribers must be regarded as conducting an economic activity and, hence, is a taxable person.¹⁰⁷⁴

An economic activity does not necessarily require a positive economic act but may consist of abstaining from activity on condition that the taxable person concerned derives remuneration from its inaction and thus supplies a service consisting in doing nothing. For example, a supply of services may consist of the obligation to refrain from an act, or to tolerate an act or situation.¹⁰⁷⁵

e. Unlawful Transactions

The principle of the fiscal neutrality of VAT precludes a generalized distinction from being drawn in the levying of VAT between unlawful and lawful transactions, except in those cases in which all competition between a lawful economic sector and an unlawful sector is ruled out. In other words, a line must be drawn between, on the one hand, transactions that lie so clearly outside the sphere of legitimate economic activity that, instead of being taxed, they can only be the subject of criminal prosecution and, on the other hand, transactions that, although unlawful, must nonetheless be taxed, if only for the sake of ensuring, in the name of fiscal neutrality, that the criminal is not treated more favorably than the legitimate trader.

It follows that goods or services that, because of their intrinsic nature or special characteristics, cannot be lawfully marketed or introduced into economic channels, do not enter within the material scope of VAT. As such, the unlawful importation into the European Union of narcotic drugs that are not confined within economic channels strictly controlled by the competent authorities for use for medical and scientific purposes falls outside the scope of VAT.¹⁰⁷⁶ However, renting out a space for the sale of narcotic drugs falls within the scope of VAT.¹⁰⁷⁷ Likewise, imports of counterfeit currency fall outside the scope of VAT.¹⁰⁷⁸

In contrast, the supply of goods or services for which commerce is authorized but that is taking place within an illegal circuit (for example, the prohibited export of computer systems (hardware and software) to certain destinations,¹⁰⁷⁹ the supply of counterfeit perfume,¹⁰⁸⁰ the organization of games of chance,¹⁰⁸¹ the contraband importation of ethyl alcohol¹⁰⁸² and exorbitant lending)¹⁰⁸³ is subject to VAT. The reason is that goods or services traded in an illegal circuit cannot, from a VAT perspec-

tive, be put at an advantage *vis-à-vis* goods and services traded in lawful economic channels with which they compete.

Further, litigious transactions that are not themselves vitiated by VAT fraud constitute supplies of goods or services effected by a taxable person acting as such and an economic activity, where they satisfy the objective criteria on which the definitions of those terms are based. This is the case regardless of the intention of a trader other than the taxable person concerned involved in the same chain of supply and/or the possible fraudulent nature of another transaction in the chain, prior or subsequent to the transaction carried out by that taxable person, of which that taxable person had no knowledge and no means of knowledge.¹⁰⁸⁴

Also, the unlawful consumption of electricity constitutes a supply of goods for consideration subject to VAT, and a distribution network operator charging a fee of compensation on this account acts as a taxable person; the reason for this is that the supply of electricity by the distribution network operator, even if involuntary and the result of unlawful conduct on the part of a third party, constitutes an economic activity of that operator, inasmuch as it gives rise to a risk inherent in its activity as an electricity distribution network operator.¹⁰⁸⁵

f. Abusive Transactions

The CJEU considers that under settled case law, the terms “supply of goods,” “supply of services,” “taxable persons” and “economic activity,” which define taxable transactions for VAT purposes, are objective in nature and apply *per se*, regardless of the purpose and result of the transaction concerned. Consequently, whether a transaction is carried out for the sole purpose or with the sole intention of obtaining a tax advantage is irrelevant in determining whether it constitutes a supply of goods or services and an economic activity. As a result, transactions constitute supplies of goods or services and economic activities subject to VAT, provided they satisfy the objective criteria on which these concepts are based, even if they have the sole aim of obtaining a tax advantage.¹⁰⁸⁶ See also XVII.D.1.a.(5), below.

g. Municipal Bodies

The supply and installation by a municipality (via an undertaking) of renewable energy systems to its residents who own their property and who have expressed their wish to be equipped with renewable energy systems does not constitute a supply of services subject to VAT, where the activity: is not intended to generate income on a continuing basis; and gives rise, on the part of those residents, solely to a payment covering at most one quarter of the costs incurred, the balance being financed by public funds.¹⁰⁸⁷

Likewise, where a municipality has arranged (by means of an undertaking) to carry out transactions involving asbestos removal and the collection of asbestos products and waste, for

¹⁰⁷⁴ Case C-8/03, *BBL*.

¹⁰⁷⁵ VATD, Art. 25(b).

¹⁰⁷⁶ Case 294/82, *Einberger II*; see also Joined Cases 269/86 and 289/86, *WRJ Mol and Happy Family*.

¹⁰⁷⁷ Case C-158/98, *Coffeshop “Siberie.”*

¹⁰⁷⁸ Case C-343/89, *Witzemann*.

¹⁰⁷⁹ Case C-111/92, *Lange*.

¹⁰⁸⁰ Case C-3/97, *Goodwin*.

¹⁰⁸¹ Case C-283/95, *Fischer*.

¹⁰⁸² Case C-455/98, *Tullihallitus v. Kaupo Salumets and Others*.

¹⁰⁸³ Case C-381/09, *Gennaro Curia*.

¹⁰⁸⁴ See, e.g., Joined Cases C-354/03, C-355/03 and C-484/03, *Optigen and Others* and Joined Cases C-439/04, *Axel Kittel* and C-440/04, *Recolta Recycling*, concerning VAT carousel or missing trader VAT fraud. See also Joined Cases C-131/13, C-163/13 and C-164/13, *Italmoda*.

¹⁰⁸⁵ Case C-677/21, *Fluvius Antwerpen*.

¹⁰⁸⁶ Case C-255/02, *Halifax and Others*.

¹⁰⁸⁷ Case C-612/21, *Gmina L.*

the benefit of its residents who own immovable property and who have expressed interest in that regard, these transactions do not constitute a supply of services subject to VAT where the activity: is not intended to generate income on a continuing basis; and does not give rise, on the part of those residents, to any payment, since the transactions are financed out of public funds.¹⁰⁸⁸ While acknowledging that the municipalities at issue in the cases make a supply *in principle*, the CJEU (following the Advocate General's Opinion) found that such a supply is not one made in the course of an economic activity. See also the discussion under XVII.C.3., below.

3. "Independence"

a. General

The condition that an economic activity should be conducted "independently" is phrased negatively in Article 10 of the VAT Directive, which excludes employed and other persons from VAT to the extent they are bound to an employer by a contract of employment or by any other legal ties creating the relationship of employer and employee as regards working conditions, remuneration and the employer's liability.¹⁰⁸⁹

b. Fixed Establishments

A fixed establishment in another Member State that is not a legal entity distinct from the company of which it forms part and to which the company supplies services should not be treated as a taxable person by reason of the costs imputed to it with respect to those supplies. This was the finding of the CJEU in *FCE Bank Ltd.*, which concerned the supply by the head office of a UK bank, FCE Bank plc, of management, consulting, data processing and employee training, and the supply and management of software to and for its permanent place of business located in Italy, FCE IT, a branch with no legal personality of its own. The Court reasoned that the branch, which did not have any endowment capital, did not itself bear the economic risks associated with carrying on the business. Rather, it was the legal person of which the branch formed a part that bore that risk. As a result, the branch was dependent on that legal person and, with it, constituted a single taxable person.¹⁰⁹⁰ In other words, the provision of services within the same legal entity does not fall within the scope of VAT and, therefore, does not constitute a taxable transaction.¹⁰⁹¹ Evidently, this finding leaves untouched the principle that a branch may well qualify as a taxable person in its transactions with third parties.¹⁰⁹²

¹⁰⁸⁸ Case C-616/21, *Gmina O.*

¹⁰⁸⁹ See Joined Cases C-78/02 to C-80/02, *Karageorgou and Others* (error-qualification as self-employed person).

¹⁰⁹⁰ Case C-210/04, *FCE Bank Ltd.*

¹⁰⁹¹ Subject to the exceptions expressly provided for by the VAT Directive (see Art. 27: "In order to prevent distortion of competition and after consulting the VAT Committee, Member States may treat as a supply of services for consideration the supply by a taxable person of a service for the purposes of his business, where the VAT on such a service, were it supplied by another taxable person, would not be wholly deductible").

¹⁰⁹² See, however, in the context of a VAT group, the *Skandia America* decision cited below.

c. Value Added Tax Groupings

Under Article 11 of the VAT Directive, each Member State may regard any "persons" established in the territory of that Member State that, while legally independent, are closely bound to one another by financial, economic and organizational links as a single taxable person, i.e., a VAT grouping.

In *Larentia + Minerva* and *Marenave*,¹⁰⁹³ the CJEU made it clear that Article 11 of the VAT Directive refers to "persons" and not to "legal persons." In the Court's opinion, therefore, Article 11 does not allow Member States to insist that only entities with legal personality that are linked to the controlling company of the group in a relationship of subordination may be members of a VAT group, except where those two requirements constitute measures that are appropriate and necessary to achieving the objectives of seeking to prevent abusive practices or behavior or to combat tax evasion or tax avoidance (which is for the referring court to determine).

This clarification is consistent with the CJEU's earlier holding in *Commission v. Sweden*¹⁰⁹⁴ to the effect that, while Member States are left with a certain margin of discretion under Article 11 of the VATD and are thus entitled to make the application of the VAT group scheme subject to certain restrictions, any such restrictions must nonetheless fall within the VATD objectives of preventing abusive practices and behavior or combatting tax evasion or tax avoidance.

In *Norddeutsche Gesellschaft für Diakonie mbH*, the CJEU indicated that national law may designate, as a single taxable person of a group formed by persons that are legally independent but closely bound to one another by financial, economic and organizational links, the controlling company of the group, where: the controlling company is in a position to impose its will on the other entities forming part of the group; and the designation does not entail a risk of tax losses.¹⁰⁹⁵ To this end, however, beyond the majority of the shares, the controlling company does not additionally have to hold the majority of the voting rights. On the other hand, in the case of a VAT grouping, the controlled companies might not be "automatically" deprived of their status as taxable persons for VAT purposes.

A number of Member States have exercised the VAT grouping option, treating a VAT group as a separate, independent taxpayer. Members of a VAT group can make inter-company supplies of goods and services without charging VAT. To the extent all members of a VAT group can fully recover VAT, the benefits of a VAT group are cash-flow advantages and administrative simplification. However, to the extent not all mem-

¹⁰⁹³ Joined Cases C-108/14 and C-109/14, *Larentia + Minerva* and *Marenave*.

¹⁰⁹⁴ Case C-480/10, *Commission v. Sweden*.

¹⁰⁹⁵ Case C-141/20, *Norddeutsche Gesellschaft für Diakonie mbH*. The CJEU thus somewhat softened the Opinion of Advocate General Medina of January 13, 2022, according to which (now) VATD, Art. 11 must be interpreted as allowing closely related persons that are members of a VAT group to be treated as a single taxable person for purposes of their VAT obligations; however, that provision must also be interpreted as precluding Member State legislation that designates solely the member controlling the group — where that member owns a majority of the voting rights and has a majority shareholding in the controlled company in the group — as the representative of the VAT group and the taxable person of that group to the exclusion of the other group members. See also the judgment in Case 269/20, *Finanzamt T*, rendered on the same date.

bers of a VAT group can recover input VAT in full, or at all, the existence of a VAT group may also yield a saving of VAT. Intra-VAT-group supplies are not subject to VAT that, if charged, might otherwise not have been fully deductible for the member of the VAT group acquiring the services. On the other hand, the inclusion in a VAT group of one or more members that are not eligible for full recovery of input VAT may result in some of the VAT charged by non-VAT-group members to VAT group members being irrecoverable, even if the VAT is related to purchases made by a member that, in the absence of a VAT group, would have been entitled to full recovery of all input VAT. Despite this possible (negative) impact on the recoverability of VAT charged by third parties, significant VAT savings can still be achieved if there are substantial intra-VAT-group supplies of services or goods, provided the cost of the intra-VAT-group supplies mainly consists of items that are not subject to VAT, such as labor.

On the basis that Article 11 of the VAT Directive refers to “persons” that can be included in a VAT group, rather than to “taxable persons” (see above), a number of Member States allow non-taxable persons (such as passive holding companies) (as well as full, mixed, partial and exempt taxable persons) to become part of a VAT group. This was challenged by the European Commission, which was concerned that these rules could give rise to potential abuse and a breach of fiscal neutrality, because the advantages of VAT registration would be available to non-taxable persons in a VAT group but not to non-taxable persons outside a VAT group. The CJEU rejected this challenge and confirmed that a non-taxable person may be a member of a VAT group — indeed, in using the word “persons” and not the words “taxable persons,” the first paragraph of Article 11 of the VATD does not make a distinction between taxable persons and non-taxable persons.¹⁰⁹⁶

In *Skandia America*,¹⁰⁹⁷ the CJEU held that treatment as a single taxable person precludes the members of a VAT group from continuing to submit VAT declarations separately and from continuing to be identified, within and outside their group, as individual taxable persons, since the single taxable person alone is authorized to submit such declarations.¹⁰⁹⁸ It follows that supplies of services made by a third party to a member of a VAT group must be considered, for VAT purposes, to have been made not to that member but to the actual VAT group to which that member belongs. This line of reasoning, which is just the ultimate consequence of the single taxpayer principle on which Article 11 of the VATD relies, was reinstated in *Danske Bank*.¹⁰⁹⁹

The benefit of the CJEU ruling of July 11, 2024 in *Finanzamt T II*¹¹⁰⁰ is that it puts an end to the uncertainty that remained (after the rulings in *Norddeutsche Gesellschaft für Diakonie mbH* and *Finanzamt T* (see above)) as regards the taxability or nontaxability of internal supplies within a VAT group.

¹⁰⁹⁶ Case C-65/11, *Commission v. Netherlands*, Case C-74/11, *Commission v. Finland*, Case C-86/11, *Commission v. United Kingdom*, Case C-95/11, *Commission v. Denmark* and Case C-109/11, *Commission v. Czech Republic*; see also Case C-85/11, *Commission v. Ireland*.

¹⁰⁹⁷ Case C-7/13, *Skandia America*.

¹⁰⁹⁸ Case C-162/07, *Ampliscentifica* and *Amplifin*.

¹⁰⁹⁹ Case C-182/19, *Danske Bank*.

¹¹⁰⁰ Case C-184/23, *Finanzamt T II*.

In an unambiguous manner and in what now seems to be settled case law, the Court considers supplies for consideration between members of the same VAT group not to be subject to VAT, even where members of the VAT group perform activities that do not carry entitlement to deduct input VAT.

d. Board Members

The activity of a member of the board of directors of a public limited company is not exercised independently to the extent the member: does not act on his or her own behalf or on his or her own responsibility (but on behalf of and under the responsibility of the board of directors); and does not bear the economic risk linked to his or her activity.¹¹⁰¹ In the case concerned, the CJEU added that any liability in tort or for tax debts is not indicative of an independent activity either in so far as such liability is ancillary to the collective liability of the collegial body (i.e. the board) or of the company.

4. Public Bodies

Article 13(1), first paragraph of the VATD stipulates that States, regional and local government authorities, and other bodies governed by public law are not regarded as taxable persons with respect to the activities or transactions in which they engage as public authorities. In carrying on such activities or transactions, they do not participate in any market and, hence, do not conduct an economic activity.¹¹⁰² In other words, their activities are non-taxable and thus outside the scope of VAT.

However, Article 13(1) second and third paragraphs of the VATD provide for two exceptions to this basic rule. First, bodies governed by public law will nevertheless be regarded as taxable persons with respect to those activities or transactions where their treatment as non-taxable persons would lead to significant distortions of competition (the “distortion clause”).¹¹⁰³ Second, they will in any event be regarded as taxable persons with respect to the activities listed in Annex I,¹¹⁰⁴ provided those activities are not carried on on such a small scale as to be negligible (the “non-negligible clause”). Furthermore, under Article 13(2), Member States may choose to treat certain tax-exempt activities engaged in by bodies governed by public law as activities in which those bodies engage as public authorities (the “exempt activities clause”). As a consequence, the VAT sta-

¹¹⁰¹ Case C-288/22, *Administration de l'Enregistrement, des Domaines and de la TVA* (TVA - Membre d'un conseil d'administration); see, *mutatis mutandis*, Case C-420/18, *IO v. Inspecteur van de rijksbelastingdienst*, concerning a member of a supervisory board.

¹¹⁰² Case C-267/08, *SPÖ Landesorganisation Kärnten v. Finanzamt Klagenfurt*.

¹¹⁰³ See, e.g., Case C-174/14, *Saudacor*: the provision by a company of planning and management services for the Regional Health Service, under the terms of a long-term contract entered into with an Autonomous Region, falls within the VATD concept of economic activity and therefore is subject to VAT, unless the company can be classified as a body governed by public law, it carries out its activity as a public authority and the exemption from VAT does not lead to a significant distortion of competition.

¹¹⁰⁴ Telecommunications services; the supply of water, gas, electricity and thermal energy; the transportation of goods; port and airport services; passenger transportation; the supply of new goods manufactured for sale; transactions with respect to agricultural goods; the organization of trade fairs and exhibitions; warehousing; the activities of commercial publicity bodies; the activities of travel agents; the running of staff shops, cooperatives and industrial canteens and similar institutions; and activities carried out by radio and television bodies to the extent these are not exempt under VATD, Art. 132(1)(q).

tus of the particular activity within its scope may change from “taxable but tax-exempt” to “non-taxable.” As a result of these provisions, an economic activity will be non-taxable if the following criteria are satisfied: (i) the activity is an activity of a body governed by public law; (ii) the public body is engaged in that activity as a public authority; (iii) the distortion clause does not apply (i.e., non-taxable treatment would not lead to a significant distortion of competition); and (iv) the non-negligible clause does not apply (i.e., either no activity listed in Annex I is carried on or a listed activity is carried on only on a negligible scale).¹¹⁰⁵

The VATD does not define what is considered a body governed by public law, other than a State, regional or local government authority. According to the CJEU, a body governed by public law must itself be part of the public administration.¹¹⁰⁶ Thus, a private person, even if exercising the powers of a public authority, can never be a body governed by public law.¹¹⁰⁷ Furthermore, a private company never falls within the scope of Article 13(1) of the VATD even if its shares are 100% held by a body governed by public law. It follows that the main purpose is to exclude all private law entities from the scope of Article 13. The definition of the public administration is more or less left to the discretion of national legislation. This causes a difference in VAT treatment as between Member States in which public tasks are to a large extent assigned to private entities and Member States in which this is not the case.

Acting under public authority requires the public body concerned to be acting under the special legal regime applicable to it; acting under the same legal conditions as those that apply to private traders excludes the public body from the scope of Article 13 of the VATD.¹¹⁰⁸ The CJEU has consistently repeated that the main criterion for “acting as a public authority” is the legal regime applicable to a public body under national law, leaving it to the discretion of the relevant national court to determine the nature of the legal regime applicable to the activity at issue.¹¹⁰⁹ Based on the traditional distinction between private and public law, this criterion is particularly difficult to handle in common law Member States, where a clear distinction between private and public law does not exist or, at least, does not exist with the same emphasis.

The distortion clause in Article 13(1), second paragraph of the VATD is designed to prevent VAT-induced unfair competition between public and private entities. Although acting under the applicable special legal regime, bodies governed by public law may, under national law, engage in activities of an essentially economic nature that can also be carried on in parallel by private operators. As a consequence, competition between public bodies and private operators is possible. Where there is competition with private operators, the rule in Article 13(1), first paragraph may lead to a distortion of such competition by treating the public body’s services as non-taxable whereas the pri-

vate competitor is obliged to charge VAT for its services. The distortion clause seeks to prevent this effect by treating both competitors in the same way for VAT purposes if, in its absence, significant distortions of competition are to be expected. As the CJEU has pointed out, the aim of the distortion clause is to ensure fiscal neutrality.¹¹¹⁰

However, the provisions of Article 13(1), second paragraph of the VATD are particularly unclear, leaving much room for interpretation. The VATD does not indicate the exact circumstances in which competition between private and public entities is considered to exist or when a distortion is considered to be significant. Furthermore, it is open to interpretation whether competition has to be already actually in existence or if the possibility of future competition suffices. The CJEU essentially clarified the scope of the distortion clause in *Isle of Wight and Others*,¹¹¹¹ in which it held that the distortion of competition must be evaluated by reference to the activity in question as such, without such evaluation relating to any local market in particular. The scope of the distortion clause encompasses not only actual competition, but also potential competition, provided the possibility of a private operator entering the relevant market is real and not purely hypothetical. As Article 13(1), first paragraph represents an exception to the basic Article 9 rule, it must be interpreted narrowly. It follows that the distortion clause, which restores the general rule that any activity of an economic nature is subject to VAT, must not be interpreted narrowly. Therefore, a distortion of competition is considered to be significant if it is more than negligible.

While the non-negligible clause in Article 13(1), paragraph 3 of the VATD pursues the same objective as the distortion clause, it uses a different approach, consisting of two elements. First, the activity at issue must be an activity listed in Annex I. Second, the activity must not be carried on such a small scale as to be negligible. The idea behind this is that the listed activities (which were traditionally carried on by public bodies in many Member States in the 1970s when the VAT law was harmonized) are presumed to lead to distortions of competition. If an activity is carried on only on a negligible scale, it can be assumed that the distortion of competition will also only be negligible. However, the transposition of this second non-negligible-scale element is optional.¹¹¹² Thus, Member States are free to treat bodies governed by public law acting under the special legal regime applicable to them as taxable persons with respect to the activities listed in Annex I even if they are carried on only on a negligible scale. Unfortunately, the CJEU has never ruled on the meaning of “such a small scale as to be negligible” with the result that the criterion is particularly difficult to deal with.

As discussed above, under Article 13(1) of the VATD, a public body must engage in the activity concerned as a public authority, that is, under the particular legal regime applicable to it. Otherwise, the activity does not fall within the scope of Article 13(1) and will give rise to taxable transactions. However, the exempt activities clause contained in Article 13(2) allows Member States nonetheless to regard a public body as

¹¹⁰⁵ See, e.g., Case C-72/13, *Gmina Wrocław v. Minister Finansów* (Order of the Court).

¹¹⁰⁶ Case C-260/98, *Commission v. Greece*.

¹¹⁰⁷ Case 235/85, *Commission v. Netherlands*.

¹¹⁰⁸ Joined Cases 231/87 and 129/88, *Carpaneto Piacentino and Rivergaro*.

¹¹⁰⁹ Case C-4/89, *Commune di Carpaneto and Others*. A similar line of reasoning is followed in Case C-628/16, *Kreuzmayr* (under express reference to *Toridas*).

¹¹¹⁰ Case C-430/04, *Halle*.

¹¹¹¹ Case C-288/07, *Isle of Wight and Others*.

¹¹¹² Joined Cases 231/87 and 129/88, *Carpaneto Piacentino and Rivergaro*; Case C-4/89, *Commune di Carpaneto and Others*.

falling within the scope of Article 13(1) if the activity at issue is covered by one of the listed exemptions. Thus, Article 13(2) broadens the scope of Article 13(1) first paragraph, offering the possibility of changing the VAT status of a transaction from taxable but tax-exempt to non-taxable. The CJEU has ruled that the application of the exempt activities clause generally requires a Member State to make an express legal provision to that effect, rather than merely applying an administrative practice.¹¹¹³

The basic exclusion from the scope of VAT where a public body engages in transactions as a public authority is subject to increasing criticism as competition between public and private bodies and resort to subcontracting and outsourcing to the private sector have become commonplace. Against this backdrop, it is not surprising that a fundamental revisiting of what is felt to be an outdated exclusion has now become a matter requiring urgent attention.¹¹¹⁴

5. “Taxpayer Acting as Such”

The CJEU has apparently never provided a positive definition of the meaning of “[a taxable person] acting as such,”¹¹¹⁵ but seems to interpret the phrase from the perspective of, and in close conjunction with, the “economic activity” (see XVII.C.1., above) and “for consideration” (see XVII.D.5., below) requirements.¹¹¹⁶

D. Material Scope — Taxable Transactions

The following transactions are, in principle, subject to VAT: (i) the supply of goods; (ii) the intra-EU acquisition of goods; (iii) the supply of services; and (iv) the importation of goods.¹¹¹⁷

However, for transactions (i), (ii) and (iii) effectively to come within the scope of VAT, (in principle¹¹¹⁸) it is also required that they should be carried out “for consideration” (the importation of goods being taxable in its own right).

1. Supply of Goods

a. Scope of “Supply of Goods”

(1) General

The first category of taxable transactions is the supply of goods for consideration within the territory of a Member State by a taxable person acting as such.¹¹¹⁹

A “supply of goods” means the transfer of the right to dispose of tangible property as owner.¹¹²⁰ In addition, each of the

following is regarded as a supply of goods:¹¹²¹ (i) the transfer, by order made by, or in the name of, a public authority or in pursuance of the law, of the ownership of property against payment of compensation; (ii) the actual handing over of goods under a contract for the hire of goods for a certain period, or for the sale of goods on deferred terms, that provides that in the normal course of events ownership is to pass at the latest on payment of the final installment; and (iii) the transfer of goods pursuant to a contract under which commission is payable on purchase or sale (the “deemed supplier” rule).¹¹²² Member States may regard the handing over of certain works of construction as a supply of goods.¹¹²³

(2) Extension to Distance Sales

With a view to extending applicable VAT rules to distance sales, Council Directive (EU) 2017/2455 of December 5, 2017¹¹²⁴ adds, with effect from January 1, 2021 (postponed to July 31, 2021 because of the COVID-19 crisis), a new paragraph 4 to Article 14 of the VATD that provides definitions of

able property by a person subject to VAT, for the benefit of the State Treasury or a local authority of a Member State, occurring in payment of tax arrears, does not constitute a supply of goods for consideration that is subject to VAT (Case C-36/16, *Posnania Investment*). By contrast, a single complex supply that encompasses access to recharging devices for electric vehicles (including integration of the charger with the vehicle operating system), the supply of electricity, within duly adjusted parameters, to the batteries of that vehicle, the necessary technical support for the user concerned and the provision of IT applications enabling the user concerned to reserve a connector, view his or her transaction history, and purchase credits that are then accumulated in an e-wallet and used to pay for recharging sessions constitutes a “supply of goods” within the meaning of VATD, Art. 14(1) (Case C-282/22, *Dyrektor Krajowej Informacji Skarbowej*).

¹¹²¹ VATD, Art. 14(2).

¹¹²² VATD, Art. 14(2)(c). The “deemed supply” rule creates a legal fiction of two identical supplies, i.e. two separate transactions occur for VAT purposes, i.e.: (i) between the principal (the initial supplier) and the intermediary that becomes a supplier; and (ii) between the intermediary and the buyer (see Case C-526/1, *Fast Bunkering Klapèda*). For VAT purposes, both supplies are treated as if they were actual supplies; accordingly, an intermediary receives VAT treatment as if it were an actual supplier/customer. An illustration may be found in Case C-312/19, *XT*: a natural person who has concluded with another natural person a joint activity agreement setting up a partnership that lacks legal personality and is characterized by the fact that the first person is empowered to act in the name of the partners as a whole, but participates alone and in his or her own name in relations with third parties when performing acts that form the economic activity pursued by the partnership, must be regarded as a “taxable person” and as having sole liability for the VAT payable, since he or she acts on his or her own behalf or on behalf of another person as a commission agent, as provided for in Article 14(2)(c). According to the CJEU there are two conditions that need to be fulfilled before applying the “deemed supplier” rule, i.e.: (i) there needs to be a commission agreement, which can be oral, between the commission agent and the principal; and (ii) the goods and services that are recharged by the commission agent need to be identical to those charged by the third-party supplier to the commission agent. Because of this broad interpretation, intermediaries who cannot be regarded as commission agents under commercial law can still fall under the “deemed supplier” rule for VAT purposes (see Case C-734/19, *ITH Comercial Timișoara*; Case C-274/15, *Commission v. Luxembourg*).

¹¹²³ VATD, Art. 14(3).

¹¹²⁴ Art. 2(1) and (2) of Council Directive (EU) 2017/2455 of December 5, 2017 amending Directive 2006/112/EC and Directive 2009/132/EC as regards certain value added tax obligations for supplies of services and distance sales of goods (OJ L 348 of December 29, 2017). See also Council Directive (EU) 2019/1995 of November 21, 2019, amending Directive 2006/112/EC and Council Implementing Regulation (EU) 2019/2026 of November 21, 2019 amending Implementing Regulation (EU) No 282/2011, also to apply from January 1, 2021 (postponed to July 31, 2021 because of the COVID-19 crisis).

¹¹¹³ Case C-102/08, *Salix*.

¹¹¹⁴ See the European Commission’s Consultation paper — Review of existing VAT legislation on public bodies and tax exemptions in the public interest: http://ec.europa.eu/taxation_customs/resources/documents/common/consultations/tax/public_bodies/consultation_document_en.pdf.

¹¹¹⁵ VATD, Arts. 2 and 4.

¹¹¹⁶ See Case 89/81, *Hong Kong Trade*; Case C-60/90, *Polysar*; Case C-155/94, *Wellcome Trust*.

¹¹¹⁷ VATD, Art. 2(1).

¹¹¹⁸ An exception to this is the intra-EU acquisitions in VATD, Arts. 21 and 22: taxable events where there is no consideration.

¹¹¹⁹ VATD, Art. 2(1)(a).

¹¹²⁰ VATD, Art. 14(1). According to the CJEU, VATD Arts. 2(1)(a) and 14(1) must be interpreted as meaning that the transfer of ownership of immov-

“intra-EU distance sales of goods” and “distance sales of goods imported from third territories or third countries.”

Intra-EU distance sales of goods means supplies of goods dispatched or transported by or on behalf of a supplier, including where the supplier intervenes indirectly in the transport or dispatch of the goods, from a Member State other than that in which the dispatch or transport of the goods to the customer ends, where: (i) the supply of goods is carried out for a non-taxable person or a person treated as such; and (ii) the goods supplied are neither new means of transport nor goods supplied after assembly or installation, with or without a trial run, by or on behalf of the supplier.

Distance sales of goods imported from third territories or third countries means supplies of goods dispatched or transported by or on behalf of a supplier, including where the supplier intervenes indirectly in the transport or dispatch of the goods, from a third territory or third country to a customer in a Member State, where: (i) the supply of goods is carried out for a non-taxable person or a person treated as such; and (ii) the goods supplied are neither new means of transport nor goods supplied after assembly or installation, with or without a trial run, by or on behalf of the supplier.

The Directive also added a new Article 14a to the effect that: (i) where a taxable person facilitates, through the use of an electronic interface such as a marketplace, platform, portal or similar means, distance sales of goods imported from third territories or third countries in consignments of an intrinsic value not exceeding 150 euros, that taxable person will be deemed to have received and supplied those goods itself (Article 14a(1)); and (ii) where a taxable person facilitates, through the use of an electronic interface such as a marketplace, platform, portal or similar means, the supply of goods within the European Union by a taxable person not established within the European Union to a non-taxable person, the taxable person that facilitates the supply will be deemed to have received and supplied those goods itself (Article 14a(2)).

As a result, as an (additional) deemed supplier rule (see above), Article 14a of the VATD splits the underlying supply into a business-to-business supply followed by a business-to-consumer supply. In considering the application of the VAT rules, these supplies must be taken into account separately, depending on whether they fall under the first or the second paragraph of Article 14a. It is worth noting that, to be regarded as a deemed supplier under Article 14a, an electronic interface such as a marketplace, platform, portal or similar means is not required to act in the name or on behalf of a principal — it need only “facilitate” the supply. Thus, although the provision seems to be an extension of Article 14(2)(c) (see above), it does not require acting as an undisclosed agent. Hence, an electronic interface such as a marketplace, platform, portal or similar means may fall within the “deemed supply” rule, irrespective of whether it intervenes as a disclosed or an undisclosed agent.¹¹²⁵

On May 17, 2023, the Commission, as part of a broad and comprehensive reform of the Customs Union, tabled a Proposal for a Council Directive amending Directive 2006/112/EC as regards VAT rules relating to taxable persons that facilitate distance sales of imported goods and the application of the special

scheme for distance sales of goods imported from third territories or third countries and special arrangements for the declaration and payment of import VAT.¹¹²⁶ The Proposal suggests three changes: (i) the removal of the 150 euro threshold, rendering all distance sales of imported goods, regardless of value, eligible for the Import One-Stop Shop (IOSS); (ii) an extension of the deemed supplier rule to all distance sales of imported goods, including those with a value of more than 150 euros, that are facilitated by an electronic interface; and (iii) an extension of the application of the “special arrangements” (see, XVII.L.6., below) as a result of the removal of the 150 euro threshold. If the Proposal is adopted “as is” as a Directive, Member States would have to apply the new rules from March 1, 2028.

(3) Assimilation to “Supply of Goods”

The application by a taxable person of goods forming part of the person’s business assets for his or her private use or for that of his or her staff, or their disposal free of charge or, more generally, their application for purposes other than those of the business is assimilated to a supply of goods for consideration, where the VAT on those goods or component parts of the goods was wholly or partly deductible.¹¹²⁷ The purpose of this assimilation is to ensure equality of treatment between a taxable person who applies goods forming part of the assets of his or her business for private use and an ordinary consumer who buys goods of the same type. In pursuit of that objective, Article 16, paragraph 1 of the VATD prevents a taxable person who has been able to deduct VAT on the purchase of goods used for his or her business from escaping the payment of VAT when that person transfers those goods from his or her business for private purposes and from thus enjoying advantages to which he or she is not entitled by comparison with an ordinary consumer who buys goods and pays VAT on them.¹¹²⁸

The provision of a subscription gift in return for taking out a subscription to periodicals constitutes a supply that is ancillary to the principal service of supplying periodicals, which falls within the concept of a “supply of goods for consideration” and must not be regarded as a disposal of goods free of charge within the meaning of the first paragraph of Article 16 of the VATD.¹¹²⁹

As a matter of symmetry, Member States may treat each of the following transactions as a supply of goods for consideration: (i) the application by a taxable person for purposes of his or her business of goods produced, constructed, extracted, processed, purchased or imported in the course of such business, where the VAT on the goods, had they been acquired from another taxable person, would not be wholly deductible; (ii) the application of goods by a taxable person for purposes of a non-taxable area of activity, where the VAT on the goods became wholly or partly deductible on their acquisition or application; and (iii) with the exception of the cases referred to in Article 19 of the VATD (see below), the retention of goods by a taxable person, or by his or her successors, when the person ceases to carry on a taxable economic activity, where the VAT

¹¹²⁵ Compare with VATD, Art. 28, discussed at XVII.D.3.a.(2).

¹¹²⁶ COM/2023/262 final.

¹¹²⁷ VATD, Art. 16, para. 1.

¹¹²⁸ Case C-20/91, *de Jong*.

¹¹²⁹ Case C-505/22, *Deco Proteste — Editores*.

on the goods became wholly or partly deductible on their acquisition or application.¹¹³⁰

The application of goods for business use as samples or gifts of small value is not treated as a supply of goods for consideration.¹¹³¹ As regards the concept of “gifts of small value,” Member States are allowed to set a monetary cap.

(4) *Transfers to Another Member State and Call-Off Stock Arrangements Exception*

The transfer by a taxable person of goods forming part of that person’s business assets to another Member State is treated as a supply of goods for consideration. “Transfer to another Member State” means the dispatch or transport of movable tangible property, by or on behalf a taxable person, for purposes of that person’s business, to a destination outside the territory of the Member State in which the property is located, but within the European Union.¹¹³²

Such an intra-EU supply is an exempt (zero-rated) supply (with a right to deduct), provided the recipient of the goods acts as a taxable person (implying that the intra-EU supply will trigger an intra-EU acquisition in the Member State of arrival).¹¹³³

It is for the supplier of the goods to prove that the conditions for the exemption are fulfilled,¹¹³⁴ which has proven to be problematic in some instances in the case of chain or triangulation supply chain transactions (see XVII.E.2.b., below).

Council Directive (EU) 2018/1910 of December 4, 2018 amending Directive 2006/112/EC as regards the harmonization and simplification of certain rules in the value added tax system for the taxation of trade between Member States inserted, as one of the “quick fixes” (see, the discussion at XVII.P., below), a new Article 17a in the VATD providing that the transfer by a taxable person of goods forming part of that person’s business assets to another Member State under call-off stock arrangements is not treated as a supply of goods for consideration. The term “call-off arrangements” refers to situations in which, at the time of the transport of goods to another Member State, the supplier already knows the identity of the person acquiring the goods to which they will be supplied at a later stage, after arrival of the goods in the Member State of destination. Such transactions, where they take place between two taxable persons, are, in certain circumstances, treated as giving rise to one exempt supply in the Member State of departure and one intra-EU acquisition in the Member State of arrival. (Under the former rules, by contrast, these transactions gave rise to a deemed supply (in the Member State of departure of the goods) and a deemed intra-EU acquisition (in the Member State of arrival of the goods), followed by a “domestic” supply in the Member State of arrival and required the supplier to be identified for VAT purposes in that Member State).

¹¹³⁰ VATD, Art. 18.

¹¹³¹ VATD, Art. 16, para. 2. For purposes of the provision, a “sample” is a specimen of a product that is intended to promote the sales of that product and that allows the characteristics and qualities of that product to be assessed without resulting in final consumption, other than where final consumption is inherent in such promotional transactions (Case C-581/08, *EMI*).

¹¹³² VATD, Art. 17(1). Art. 17(2) enumerates a number of transactions that are not regarded as transfers to another Member State.

¹¹³³ Case C-409/04, *Teleos and Others*.

¹¹³⁴ Case C-409/04, *Teleos and Others*; Case C-184/05, *Twoh*.

Under the VAT in the Digital Age (ViDA) Package, formally adopted by the Council on March 11, 2025 (see XVII.O., below), call-off arrangements will be phased out by the end date of June 30, 2028 after which date it will no longer be possible to effectuate any new call-off stock arrangements. For call-off stock arrangements commencing on or before June 30, 2028, the relevant conditions, including the 12-month time limit for transferring ownership of those goods to the intended purchaser, will continue to apply. In parallel with the inclusion of the new end date, however, those arrangements will cease to apply on June 30, 2029, as they will no longer be required after that date. The abolishment of the call-off stock simplification is due to the introduction of the (new) special scheme of transfer of own goods and the extension of the mandatory reverse charge rule under ViDA, rendering the call-off simplification redundant.

(5) *Transfer of Totality of Assets or Part Thereof*

In the event of a transfer, whether or not for consideration or as a contribution to a company, of a totality of assets or part thereof, Member States may consider that no supply of goods has taken place and that the person to which the goods are transferred is to be treated as the successor to the transferor.¹¹³⁵

According to the CJEU,¹¹³⁶ the concept of a “transfer, whether for consideration or not or as a contribution to a company, of a totality of assets or part thereof” constitutes an independent concept of EU law that must be given a uniform interpretation throughout the European Union. There being no definition of that concept in the VATD, and no express reference to the law of the Member States, its meaning and scope must be identified in light of the context of the provision and the purpose of the legislation in question. The provision is intended to enable the Member States to facilitate transfers of undertakings or of parts of undertakings by making such transfers simpler, and by preventing the resources of the recipient from being overburdened by a disproportionate charge to tax that, in any event, would ultimately be recovered through the deduction of the input VAT paid. Against this backdrop, the concept of a “transfer (...) of a totality of assets or part thereof” must be interpreted as covering the transfer of a business or of an independent part of an undertaking, including tangible elements and, as the case may be, intangible elements, that, together, constitute an undertaking or a part of an undertaking that is capable of carrying on an independent economic activity, but not as covering the simple transfer of assets, such as the sale of a stock of goods.¹¹³⁷

It follows that all of the elements transferred must, together, be sufficient to allow an independent economic activity to be carried on. To this end, an overall assessment must be made of the factual circumstances of the transaction at issue to determine whether it is covered by the concept of the transfer of a totality of assets for purposes of the VATD. In making that assessment, particular importance must be attached to the nature of the economic activity that it is sought to continue. It is also necessary for the transferee to intend to operate the business, or the part of the undertaking, that is transferred and not simply to

¹¹³⁵ VATD, Art. 19.

¹¹³⁶ Case C-497/01, *Zita Modes*.

¹¹³⁷ Case C-497/01, *Zita Modes* and Case C-29/08, *SKF*.

liquidate the activity concerned immediately and sell the stock, if any.¹¹³⁸ For example, there is a transfer of a totality of assets or a part thereof, where the stock and fittings of a retail outlet are transferred concomitantly with the conclusion of a contract of lease, to the transferee, of the premises of that outlet for an indefinite period but one that is terminable at short notice by either party, provided the assets transferred are sufficient for the transferee to be able to carry on an independent economic activity on a lasting basis.¹¹³⁹

Pure share sales are unlikely to qualify as transfers of a going concern. While the CJEU at one point ruled that the transfer of a 100% shareholding could amount to a transfer of assets,¹¹⁴⁰ subsequent case law appears to have cast some doubt on the correctness, or at least the wider application, of that ruling. For example, concerning a disposal of 30% of the shares in a company to which the transferor supplies services that are subject to VAT, the CJEU decided that this does not amount to the transfer of a totality of assets or services or part thereof, irrespective of the fact that the other shareholders transfer all the other shares in that company to the same person at practically the same time and that the disposal is closely linked to management activities carried out for that company.¹¹⁴¹

b. Right to Dispose as Owner

As already indicated, a “supply of goods” means the transfer of the right to dispose of tangible property as owner. The CJEU’s reading of the concept “right to dispose as owner” is more economic than juridical.¹¹⁴² It is not necessary to distinguish the various legal forms, in particular, between the acquisition of a right to the transfer of the future ownership of property and the acquisition of the property itself.¹¹⁴³ “Supply of goods” does not refer to the transfer of ownership in accordance with the procedures prescribed by the applicable national law but covers any transfer of tangible property by one party that empowers the other party actually to dispose of it as if the other party were the owner of the property. This view is in accordance with the purpose of the VATD, which is designed *inter alia* to base the common system of VAT on a uniform definition of taxable transactions. This objective might be jeopardized if the preconditions for a supply of goods varied from one Member State to another, as do the conditions governing the transfer of ownership under civil law. Consequently, the “supply of goods” must be interpreted as meaning the transfer of the right to dispose of tangible property as owner, even if there is no transfer of legal ownership of the property.¹¹⁴⁴ For example, there is a supply of goods if a good is stored between its

transfer and its actual material reception.¹¹⁴⁵ The theft of goods is not covered by the concept of “supply of goods” as it makes the thief the mere possessor of the goods and does not have the effect of empowering him or her to dispose of the goods under the same conditions as their owner.¹¹⁴⁶

c. Tangible Property

Tangible property includes any physical goods. For purposes of VAT, electricity, gas, heat, refrigeration and the like are treated as tangible property.¹¹⁴⁷

In addition, Member States may regard the following as tangible property: (i) certain interests in immovable property; (ii) rights *in rem* giving their holder a right of use over immovable property; and (iii) shares or interests equivalent to shares giving their holder *de jure* or *de facto* rights of ownership or possession over immovable property or part thereof.¹¹⁴⁸

d. Supply of Goods v. Supply of Services — Composite Supplies — Conflicts of Characterization

To determine whether a transaction constitutes a supply of goods or a supply of services, regard must be had to all the circumstances in which the transaction in question takes place with a view to identifying its characteristic features.¹¹⁴⁹ For example, the supply of prepared food and drink for immediate consumption is the outcome of a series of services ranging from the cooking of the food to its physical service to a recipient, while at the same time infrastructure is placed at the customer’s disposal, including a dining room with appurtenances (cloak rooms, etc.), furniture and crockery. Consequently, restaurant transactions must be regarded as supplies of services as they are characterized by a cluster of features and acts, of which the provision of food is only one component and in which services largely predominate. The situation would be different, however, where the transaction related to “take-away” food and was not coupled with services designed to enhance consumption on the spot in an appropriate setting.¹¹⁵⁰ In determining whether a supply is a supply of goods or a supply of services, a further key factor is whether the supply involves tangible property. For example, with regard to currency exchange transactions performed by a bank, currencies exchanged against other currencies cannot be classified as tangible property, since they involve money being used as legal tender; hence, such transactions constitute supplies of services.¹¹⁵¹

In a landmark decision of October 22, 2015,¹¹⁵² the CJEU held that transactions involving the exchange of traditional currency for “bitcoin” virtual currency or vice versa that are effected for consideration added by the supplier when the exchange rates are determined constitute the supply of a service effect-

¹¹³⁸ Case C-497/01, *Zita Modes* and Case C-29/08, *SKF*.

¹¹³⁹ Case C-444/10, *Finanzamt Lüdenscheid v. Christel Schriever*.

¹¹⁴⁰ Case C-29/08, *SKF*.

¹¹⁴¹ Case C-651/11, *X v. Staatsecretaris van Financiën*.

¹¹⁴² See, e.g., Case C-209/14, *NLB Leasing*: where a lease agreement relating to immovable property provides either that ownership of the property is to be transferred to the lessee on the expiry of the agreement or that all the essential powers attaching to ownership of the property are to be enjoyed by the lessee and, in particular, substantially all the rewards and risks incidental to legal ownership of the property are transferred to the lessee and the present value of the amount of the lease payments is practically identical to the market value of the property, the transaction resulting from the agreement must be treated as an acquisition of capital goods.

¹¹⁴³ Case 268/83, *Rompelman*.

¹¹⁴⁴ Case 320/88, *SAFE BV*.

¹¹⁴⁵ Case C-185/89, *Velker*.

¹¹⁴⁶ Case 435/03, *British American Tobacco*.

¹¹⁴⁷ VATD, Art. 15(1).

¹¹⁴⁸ VATD, Art. 15(2).

¹¹⁴⁹ Case C-231/94, *Faaborg*.

¹¹⁵⁰ Case C-231/94, *Faaborg*.

¹¹⁵¹ Case C-172/96, *First National Bank of Chicago*.

¹¹⁵² Case C-264/14, *Hedqvist*. While the case seems only to apply to virtual currencies, such as bitcoin, it is asserted that the CJEU’s “bitcoin” ruling could also impact future technological developments such as smart contracts, Blockchain-based software systems in place between banks and insurers, and communication between devices within the Internet-of-Things.

ed for consideration since bitcoins cannot be characterized as “tangible property” referred to in Article 14 of the VATD. According to the CJEU, it is clear that the exchange of traditional currency for units of bitcoin, in return for payment of a sum equal to the difference between the price paid by the operator to purchase the currency and the price at which the operator sells the currency to clients, constitutes a supply of services for consideration within the meaning of Article 2(1)(c) of the VATD.

Another key feature is the right to dispose as an owner, which is a constitutive element for a supply of goods but not for a supply of services. For example, the provision of retail vouchers by an employer to employees as part of their remuneration constitutes a supply of services, not a supply of goods, since such vouchers only confer a future right to goods or services and, therefore, do not immediately transfer the right to dispose of property.¹¹⁵³

The distinction between goods and services becomes even more important when supplies consist of both tangible and intangible property and, thus, are composite or bundled supplies.

A composite supply is a single supply with more than one component; the different components may be a mixture of goods, services, or goods and services. The CJEU developed its position regarding composite supplies in two landmark decisions. In *Card Protection Plan*,¹¹⁵⁴ which involved a business that offered an insurance service for credit cards, including the registration of cards, insurance cover for the fraudulent use of cards, the ordering of replacement cards, change of address notification, lost luggage recovery, emergency medical cover and the provision of emergency cash, the CJEU had to decide whether the service amounted to one VAT-exempt supply of insurance services or a multiple supply including exempt insurance and standard-rated credit card registration services. After observing that the basic principle is that every supply must normally be regarded as distinct and independent, the CJEU reached the decision that a supply comprising a single supply from an economic point of view should not be artificially split, so as not to distort the functioning of the VAT system. This is the case, in particular, where one of the elements is to be regarded as constituting the principal service, while one or more elements are to be regarded, by contrast, as ancillary services (which share the tax treatment of the principal service). In that context, the CJEU emphasized that a service must be regarded as ancillary to a principal service if it does not constitute for customers an aim in itself, but a means of better enjoying the principal service supplied. The fact that a single price is charged is not decisive for this purpose, although the CJEU acknowledged that, if the service provided to customers consists of several elements for a single price, the single price might suggest that there is a single service.¹¹⁵⁵ In summary, the CJEU considered that there is a composite (and, hence, a single) supply when one or several supplies are ancillary to a “principal” supply, i.e., merely constitute a means of better enjoying the principal supply. It is therefore the principal supply that will determine whether the composite supply is to be classified as a supply of goods or as a supply of services.

This analysis was further refined (and extended) in *Levob*,¹¹⁵⁶ a case that concerned a license to use standard software granted by a US supplier to a Dutch insurance company and the subsequent customization of the software by the US supplier. The CJEU found that, where two or more elements or acts supplied by a taxable person to a typical customer are so closely linked that they form objectively, from an economic point of view, a whole transaction that it would be artificial to split, all those elements or acts constitute a single supply for purposes of the application of VAT. In other words, where two or more elements supplied are so closely linked that they form a single, indivisible economic supply, this amounts to a composite supply. On that basis, the CJEU concluded that the whole transaction was a supply of functional software that was customized to the customer’s requirements and therefore constituted one composite supply subject to VAT at the standard rate. In line with the *Faaborg*-case law referred to above, such an “indivisible” supply is then to be classified as a supply of goods or a supply of services in terms of the function of its key characteristics.

In *Mydibel*,¹¹⁵⁷ a case concerning a Belgian company that entered into two financial transactions in the form of sale and lease back arrangements that were not subject to VAT (i.e., the granting of long leases on buildings via emphyteutic rights against the payment of emphyteutic rents and the immediate lease-back of those buildings), the CJEU seems to take the use of the composite supply doctrine even a step further by applying the doctrine to a transaction carried out by two separate taxable persons (*Mydibel* and the leasing company), and by applying the doctrine to two supplies, i.e., the sale/creation of emphyteutic right on the one hand, and the lease-back on the other (which the Court considers to constitute a single transaction).

In *Wojskowa Agencja Mieszkaniowa w Warszawie*,¹¹⁵⁸ the CJEU held that the letting of immovable property and the supply of water, electricity and heating, as well as waste management accompanying that letting, must, in principle, be regarded as constituting a number of distinct and independent supplies that need to be assessed separately for VAT purposes. However, those supplies are deemed to be a single complex supply if their different elements are closely linked, in such a way that they form, objectively, a single, indivisible economic supply, that it would be artificial to split. For this purpose, it is necessary to analyze the economic rationale based on the conclusion of the contract. If the lessee is not able to choose freely the suppliers and the terms of use of the goods or services provided with the letting, this indicates that the supplies and the letting must be considered a single supply for VAT purposes.

There is also a single supply where one or more elements are to be regarded as constituting the principal supply, while other elements are to be regarded, by contrast, as one or more ancillary supplies that share the tax treatment of the principal supply. In particular, a supply must be regarded as ancillary to a principal supply if it does not constitute for customers an end in

¹¹⁵³ Case C-40/09, *Astra Zeneca*.

¹¹⁵⁴ Case C-349/86, *Card Protection Plan*.

¹¹⁵⁵ See, e.g., Case C-224/11, *BGZ Leasing*.

¹¹⁵⁶ Case C-41/04, *Levob Verzekeringen*.

¹¹⁵⁷ Case C-201/18, *Mydibel*.

¹¹⁵⁸ Case C-42/14, *Wojskowa Agencja Mieszkaniowa w Warszawie*. See also Case C-555/15, *Gabarel* (Order of the Court); Case C-273/16, *Federal Express Europe*.

itself but a means of better enjoying the principal service supplied.¹¹⁵⁹

In *Stock '94*,¹¹⁶⁰ the CJEU held that an integrated agricultural cooperation arrangement providing for an economic operator to deliver goods to farmers and granting the farmers loans intended to enable the purchase of those goods constitutes a single transaction for VAT purposes, in which the supply of the goods is the principal supply. The taxable amount of that single transaction is made up of both the price of the goods and the interest paid on the loans granted to the farmers. The fact that an integrator may provide the farmers with additional services or buy their agricultural product has no bearing on the categorization of the transaction at issue as a single transaction.

In *Höggkullen*,¹¹⁶¹ the CJEU held that the various services a holding company provides to its subsidiaries do not constitute a unique composite service. The Court considered that the services involved (business management, finance, property management, IT and personnel administration) were not unique as all these services were available on the market and could be acquired separately. For transfer pricing purposes, this implies that the market value of the various services should be determined based on a comparable market price for each service. See, XVII.D.5.b., below.

To summarize, the classification of a composite supply as a supply of goods or a supply of services depends on what supply predominates, which is to be determined by taking into account and comparing the extent, cost and/or duration of each of the supplies in question.

Despite the definitions of “supply of goods” and “supply of services” in the VATD (and, insofar as services are concerned, in the VAT Implementing Regulation — see XVII.D.3., below) and the guidance given by the CJEU, Member States continue to characterize certain transactions differently, leading to double taxation or nontaxation. Businesses can take advantage of the fact that certain Member States treat certain transactions as supplies of goods, while other Member States treat the same transactions as supplies of services. Indeed, in *RBS*,¹¹⁶² the CJEU declared that, where it is possible for taxable persons to choose from a number of transactions, they may choose to structure their business in such a way as to limit their tax liability. Consequently, a company established in one Member State has the right to elect to have its subsidiary established in another Member State carry out transactions for a third company established in the first Member State to avoid VAT on those transactions. According to this case law, channeling a transaction through another Member State with the aim of avoiding VAT is not a prohibited abusive practice, at least if non-taxation is the result of the different characterizations given to the transaction by the Member States involved.

e. Common Supply of Goods/Supply of Services Rules for Vouchers

Council Directive (EU) 2016/1065 of June 27, 2016, amending Directive 2006/112/EC as regards the treatment of vouchers inserted new Articles 30a and 30b (as new Chapter 5) in the VATD, applicable to vouchers issued from December 31, 2018 onwards.

For VATD purposes, “voucher” means an instrument that carries an obligation to accept it as consideration or part consideration for a supply of goods or services, where the goods or services to be supplied or the identities of their potential suppliers are either indicated on the instrument itself or in related documentation, including the terms and conditions of use of the instrument. “Single-purpose voucher” means a voucher where the place of supply of the goods or services to which the voucher relates, and the VAT due on those goods or services, are known at the time of issue of the voucher.¹¹⁶³ “Multi-purpose voucher” means a voucher other than a single-purpose voucher.¹¹⁶⁴

Each transfer of a single-purpose voucher made by a taxable person acting in its own name constitutes a supply of the goods or services to which the voucher relates. The actual handing over of the goods or the actual provision of the services in return for a single-purpose voucher accepted as consideration or part consideration by the supplier does not constitute an independent transaction. Where a transfer of a single-purpose voucher is made by a taxable person acting in the name of another taxable person, that transfer is considered to be a supply of the goods or services to which the voucher relates made by the other taxable person in whose name the taxable person is acting. Where the supplier of goods or services is not the taxable person that, acting in its own name, issued the single-purpose voucher, that supplier is however deemed to have made the supply of the goods or services related to that voucher to that taxable person. The actual handing over of the goods or the actual provision of the services in return for a multi-purpose voucher accepted as consideration or part consideration by the supplier is subject to VAT, while each preceding transfer of that multi-purpose voucher is not subject to VAT. Where a transfer of a multi-purpose voucher is made by a taxable person other than the taxable person carrying out the transaction subject to VAT, any supply of services that can be identified, such as distribution or promotion services, is subject to VAT.¹¹⁶⁵

Loyalty points do not qualify as vouchers.¹¹⁶⁶ As regards the taxable amount, see the discussion at XVII.G.1.a., below.

¹¹⁵⁹ Case C-463/16, *Stadion Amsterdam*.

¹¹⁶⁰ Case C-208/15, *Stock '94*.

¹¹⁶¹ Case C-808/23, *Höggkullen*.

¹¹⁶² Case C-277/09, *RBS*. The case involved a UK parent company that had channeled a leasing transaction through its German subsidiary because the German tax authorities took the view that the leasing transaction was a supply of goods (that was deemed to be made in the United Kingdom), while the UK tax authorities took the view that the same transaction was the supply of a service (that was deemed to be supplied at the place where the lessor was established, i.e., in Germany).

¹¹⁶³ Case C-68/23, *M-GbR vs. Finanzamt O* (gift cards issued by Sony for the Sony PlayStation Store (PSN Cards) for which an end-consumer was able to purchase digital content; cards could only be redeemed by user accounts registered to a German address according to Sony's specifications).

¹¹⁶⁴ VATD, Art. 30a.

¹¹⁶⁵ VATD, Art. 30b.

¹¹⁶⁶ Case C-436/24, *Lyko*. The judgment leaves uncertainty about the VAT treatment of the bonus goods themselves (free supply or part of the paid transaction) — further clarification may follow in Case T-914/25, *Modelo Continente Hipermercados*, currently pending before the General Court.

2. Intra-European Union Acquisition of Goods

The second category of transactions falling within the scope of VAT is the intra-EU acquisition of goods for consideration within the territory of a Member State.¹¹⁶⁷

An “intra-EU acquisition of goods” means the acquisition of the right to dispose, as owner, of movable tangible property dispatched or transported to the person acquiring the goods, by or on behalf of the vendor or the person acquiring the goods, in a Member State other than that in which the dispatch or transportation of the goods began.¹¹⁶⁸

Where goods acquired by a non-taxable legal person are dispatched or transported from a third territory or a third country and imported by that non-taxable legal person into a Member State other than the Member State in which the dispatch or transportation of the goods ends, the goods are regarded as having been dispatched or transported from the Member State of importation.¹¹⁶⁹

The application by a taxable person, for purposes of its business, of goods dispatched or transported by or on behalf of that taxable person from another Member State, within which the goods were produced, extracted, processed, purchased or acquired within the meaning of Article 2(1)(b) of the VATD, or into which they were imported by that taxable person for purposes of its business, are assimilated to an intra-EU acquisition of goods for consideration.¹¹⁷⁰

Certain intra-EU acquisitions are exempt from VAT under Article 2(1)(b) of the VATD (i.e., in an *a contrario* reading of that provision) — such acquisitions are excluded from the scope of VAT. Where this is the case, the transaction concerned is deemed not to take place for VAT purposes. Other intra-EU acquisitions are exempt under Articles 3 and 4 of the VATD. These are handled differently from those under Article 2, although the wording, “subject to VAT,” is similar in both provisions. While a transaction that is exempt under Article 2 is deemed not to take place (for VAT purposes), a transaction that is exempt under Articles 3 or 4 is merely not to be charged with VAT. In this case the acquisition does take place, but is zero-rated.

3. Supply of Services

a. Scope of “Supply of Services”

(1) Concept and Examples

The third category of transactions falling within the ambit of VAT is the supply of services for consideration within the territory of a Member State by a taxable person acting as such.¹¹⁷¹

The concept of a “supply of services” is negatively defined as any transaction that does not constitute a supply of goods.¹¹⁷²

Examples of “services” given in the VATD include: telecommunications services (i.e., services relating to the transmission, emission or reception of signals, words, images and sounds or information of any nature by wire, radio, optical or other electromagnetic systems, including the related transfer or assignment of the right to use capacity for such transmission, emission or reception, with the inclusion of the provision of access to global information networks);¹¹⁷³ the assignment of intangible property, whether or not the subject of a document establishing title;¹¹⁷⁴ the obligation to refrain from an act, or to tolerate an act or situation;¹¹⁷⁵ and the performance of services in pursuance of an order made by, or in the name of, a public authority or in pursuance of the law.¹¹⁷⁶

Further examples or specifications of “services” are set out in the VAT Implementing Regulation, as follows:

- (i) Restaurant and catering services, i.e., services consisting of the supply of prepared or unprepared food or beverages or both, for human consumption, accompanied by sufficient support services to allow for their immediate consumption. The provision of food or beverages or both is only one component of the whole in which services must predominate; restaurant services are the supply of such services on the premises of the supplier, and catering services are the supply of such services off the premises of the supplier.¹¹⁷⁷ The supply of prepared or unprepared food or beverages or both, whether or not including transport but without any other support services, is not considered a supply of restaurant or catering services.¹¹⁷⁸
- (ii) Electronically supplied services, as referred to in the VATD, include services delivered over the internet or an electronic network, the nature of which renders their supply essentially automated, involving minimal human intervention, and impossible to ensure in the absence of infor-

terminated in advance. On the other hand, such a supply of a horse for purposes of its participation in a race constitutes a supply of services for consideration where it gives rise to the payment, by the organizer, of remuneration irrespective of whether the horse in question is placed in the race. See also Case C-43/19, *Vodafone Portugal*, in which the CJEU held that Art. 2(1)(c) must be interpreted as meaning that amounts received by an economic operator in the event of early termination, for reasons specific to the customer, of a services contract requiring compliance with a tie-in period in exchange for granting that customer advantageous commercial conditions, must be considered to constitute the remuneration for a supply of services for consideration, within the meaning of that provision.

¹¹⁷² VATD, Art. 24(1). See, e.g., Case C-209/14, *NLB Leasing*: where a lease agreement relating to immovable property provides either that ownership of the property is to be transferred to the lessee on the expiry of the agreement or that all the essential powers attaching to ownership of the property are to be enjoyed by the lessee and, in particular, substantially all the rewards and risks incidental to legal ownership of the property are transferred to the lessee and the present value of the amount of the lease payments is practically identical to the market value of the property, the transaction resulting from that agreement must be treated as an acquisition of capital goods.

¹¹⁷³ VATD, Art. 24(2).

¹¹⁷⁴ VATD, Art. 25(a).

¹¹⁷⁵ VATD, Art. 25(b).

¹¹⁷⁶ VATD, Art. 25(c).

¹¹⁷⁷ VAT Implementing Regulation, Art. 6(1).

¹¹⁷⁸ VAT Implementing Regulation, Art. 6(2).

¹¹⁶⁷ VATD, Art. 2(1)(b).

¹¹⁶⁸ VATD, Art. 20, para. 1.

¹¹⁶⁹ VATD, Art. 20, para. 2.

¹¹⁷⁰ VATD, Art. 21.

¹¹⁷¹ VATD, Art. 2(1)(c). See, e.g., Case C-432/15, *Baštová*, in which the CJEU held that the supply of a horse by its owner, a taxable person for VAT purposes, to the organizer of a horse race for purposes of the horse's participation in that race does not constitute a supply of services for consideration within the meaning of Art. 2(1)(c) where it does not give rise to a payment awarded for participation or any other direct remuneration and where only the owners of horses that are placed in the race receive a prize, even if that prize is de-

mation technology.¹¹⁷⁹ The concept of “electronically supplied services” covers, in particular: the supply of digitized products generally, including software and changes to, or upgrades of, software; services providing or supporting a business or personal presence on an electronic network such as a website or a webpage; services automatically generated from a computer via the Internet or an electronic network in response to specific data input by the recipient; the transfer for consideration of the right to put goods or services up for sale on an internet site operating as an online market on which potential buyers make their bids via an automated procedure and on which the parties are notified of a sale by electronic mail automatically generated from a computer; Internet Service Packages (ISP) of information of which the telecommunications component forms an ancillary and subordinate part (i.e., packages going beyond mere Internet access and including other elements such as content pages giving access to news, weather or travel reports, playgrounds, website hosting and access to online debates); and the services listed in Annex I.¹¹⁸⁰ The concept of “electronically supplied services” does not cover, in particular: radio and television broadcasting services; telecommunications services; goods, where the order and processing is done electronically; CD-ROMs, floppy disks and similar tangible media; printed matter, such as books, newsletters, newspapers or journals; CDs and audio cassettes; video cassettes and DVDs; games on a CD-ROM; the services of professionals such as lawyers and financial consultants who advise clients by e-mail; teaching services, where the course content is delivered by a teacher over the Internet or an electronic network (i.e., via a remote link); offline physical computer equipment repair services; offline data warehousing services; advertising services, in particular, in newspapers, on posters and on television; telephone helpdesk services; teaching services purely involving correspondence courses, such as postal courses; conventional auctioneers’ services reliant on direct human intervention, irrespective of how bids are made; telephone services with a video component, otherwise known as videophone services; access to the Internet and World Wide Web; or telephone services provided through the internet.¹¹⁸¹

(iii) If a taxable person only assembles the various parts of a machine, all of which were provided to it by its customer, the transaction constitutes a supply of services within the meaning of Article 24(1) of the VATD.¹¹⁸²

(iv) The sale of an option, where the sale is a transaction falling within the scope of point (f) of Article 135(1) of the VATD, is a supply of services within the meaning of Article 24(1) of the VATD and is to be considered distinct from the underlying transactions to which the services relate.¹¹⁸³

The operation of agricultural engineering works constitutes a supply of services for consideration, on the grounds that the services rendered are directly linked to the fee received or to be received, provided that modest fee constitutes remuneration for the service supplied and notwithstanding the fact that performance of those services is a legal obligation. What must be ascertained to classify services as being effected for consideration is that the fee does not only partly remunerate the services supplied or to be supplied and that its amount has not been determined as a result of other possible factors that could, depending on the circumstances, call into question the direct link between the services supplied and the consideration.¹¹⁸⁴

By the same logic as that prevailing in the context of supplies of goods, the following transactions are assimilated to supplies of services for consideration: (i) the use of goods forming part of the assets of a business for the private use of a taxable person or of the person’s staff or, more generally, for purposes other than those of the person’s business, where the VAT on the goods was wholly or partly deductible; and (ii) the supply of services carried out free of charge by a taxable person for the person’s private use or for that of the person’s staff or, more generally, for purposes other than those of the person’s business.¹¹⁸⁵

Finally, Article 19 of the VATD applies to the supply of services in the same way as it applies to the supply of goods, so that, in the event of a transfer, whether for consideration or not or as a contribution to a company, of a totality of assets or part thereof, Member States may consider that no supply of services has taken place.¹¹⁸⁶

(2) “Deemed Supplier” Rule — Online Platforms

Article 28 of the VATD lays down a presumption that a taxable person that, acting in its own name but on behalf of another person (i.e. an undisclosed agent), takes part in a supply of services is deemed to have received and supplied those services itself. In a way, this is the counterpart, in the context of the supply of services, of the “deemed supplier” rule set out in Article 14(2)(c) of the VATD that applies in the context of the supply of goods (see XVII.D.1.a.(1), above). As in the case of Article 14(2)(c) of the VATD, Article 28 creates a legal fiction of two identical supplies of services provided consecutively, i.e. when an undisclosed agent takes part in a supply of services between two other persons, two separate transactions occur for VAT purposes: (i) between the principal (the initial supplier) and the intermediary that becomes a supplier; and (ii) between the intermediary and the buyer.¹¹⁸⁷ For VAT purposes, both supplies are treated as if they were actual supplies; accordingly, the intermediary receives the VAT treatment it would receive if it were an actual supplier/customer.

The legal fiction of Article 28 of the VATD is further elaborated on in Article 9a of the VAT Implementing Regulation,

¹¹⁸⁴ Case C-263/15, *Lajvér*.

¹¹⁸⁵ VATD, Art. 26.

¹¹⁸⁶ VATD, Art. 29.

¹¹⁸⁷ See, Case C-274/15, *Commission v. Luxembourg*: “[u]nder that fiction, the operator, who takes part in the supply of services and who constitutes the commission agent, is considered to have, firstly, received the services in question from the operator on behalf of whom it acts, who constitutes the principal, before providing, secondly, those services to the client himself” (referring to Case C-464/10, *Henfling and Others*).

¹¹⁷⁹ VAT Implementing Regulation, Art. 7(1).

¹¹⁸⁰ VAT Implementing Regulation, Art. 7(2).

¹¹⁸¹ VAT Implementing Regulation, Art. 7(3).

¹¹⁸² VAT Implementing Regulation, Art. 8.

¹¹⁸³ VAT Implementing Regulation, Art. 9.

which (subject to certain conditions) applies the “deemed supplier” rule to instances in which electronically supplied services are supplied through a telecommunications network, an interface or a portal such as a marketplace for applications (an “online platform”). In that case, the online platform will be presumed to be acting in its own name but on behalf of the provider of the services.

The “deemed seller” presumption of Article 9a of the VAT Implementing Regulation can be rebutted by showing that the service provider is explicitly indicated as the supplier by the platform and this is reflected in the contractual arrangements between the parties. Specifically, to regard the provider of electronically supplied services as being explicitly indicated as the supplier of those services by the taxable person, the invoice issued or made available by each taxable person taking part in the supply of the electronically supplied services must identify the services and their supplier and the bill or receipt issued or made available to the customer must identify the electronically supplied services and their supplier.

On the other hand, Article 9a also sets out the situations in which the presumption does not apply, i.e., where a taxable person only provides for the processing of payments with respect to electronically supplied services or telephone services provided through the internet, including voice over internet Protocol (VoIP), and does not take part in the supply of the electronically supplied services or telephone services. In these instances, the service provider is responsible for collecting the VAT.

In *Fenix International*,¹¹⁸⁸ the CJEU held that the deemed supplier provision of Article 9a of the VAT Implementing Regulation is intended to ensure the uniform application of Article 28 of the VATD to services that are electronically supplied via platforms. According to the Court, the deemed reseller provision does not alter the nature of the presumption in Article 28, but merely provides context for the specific services covered under Article 9a. In other words, the Council did not go beyond its implementing powers when adopting Article 9a.

b. *Supply of Services v. Supply of Goods — Composite Supplies*

See the discussion at XVII.D.1.d., above.

c. *Common Supply of Goods/Supply of Services Rules for Vouchers*

See the discussion at XVII.D.1.e., above.

4. *Importation of Goods*

The “importation of goods” refers to the entry into the European Union of goods that are not in free circulation within the meaning of Article 29 of the TFEU. Under that provision, products coming from a third country are considered to be in free circulation in a Member State if the import formalities have been complied with and any customs duties or charges having equivalent effect that are payable have been levied in that Member State, and if they have not benefited from a total or partial drawback of such duties or charges. In addition, the entry into the European Union of goods that are in free circulation, coming from a third territory forming part of the customs

territory of the European Union, is also regarded as the importation of goods.¹¹⁸⁹

5. *“For Consideration”*

a. *Principles*

For a supply of goods, an intra-EU acquisition of goods or a supply of services effectively to fall within the scope of VAT, it is (in principle¹¹⁹⁰) also required that the supply be carried out “for consideration.” An importation of goods is taxable in its own right.

The “for consideration” requirement means that the existence of a valuable counterpart is necessary. The term “consideration” refers to a subjective value that must be capable of being expressed in monetary terms.¹¹⁹¹ Goods or services are supplied “for consideration” only if there is a legal relationship between the supplier and the purchaser entailing reciprocal performance, the price received by the supplier constituting the value actually given in return for the goods or services supplied.¹¹⁹²

It follows that, where a person’s activity consists exclusively in supplying goods or services for no direct consideration, there is no basis of assessment and the free supplies in question are therefore not subject to VAT. The reason for this is that, in such circumstances, the person providing the goods or services must be assimilated to a final consumer because that person is at the final stage of the production and distribution chain. In fact, the link between that person and the recipient of the goods or service does not fall within any category of contract likely to be the subject of tax harmonization giving rise to neutrality in competition. In those circumstances, goods or services provided free of charge are different in character from taxable transactions, which, within the framework of the VAT system, presuppose the stipulation of a price or consideration.¹¹⁹³

However, supplies provided free of charge in appearance only are not necessarily excluded from the scope of taxable transactions. For example, the application by an oil company of goods that are disposed of to a purchaser of fuel in exchange for vouchers that the purchaser has obtained in varying quantities, depending on the volume of fuel purchased, on payment of the full retail price for fuel from the pump, under a sales promotion scheme, must be treated as a supply for consideration.¹¹⁹⁴ Like-

¹¹⁸⁹ VATD, Art. 30.

¹¹⁹⁰ An exception to this is intra-EU acquisitions under VATD, Arts. 21 and 22: taxable events where there is no consideration.

¹¹⁹¹ Case 154/80, *Coöperatieve Aardappelenbewaarplaats GA*. See with respect to termination fees, Case C-43/19, *Vodafone Portugal*, in which the CJEU held that amounts received by an economic operator in the event of early termination, for reasons specific to the customer, of a services contract requiring compliance with a tie-in period in exchange for granting that customer advantageous commercial conditions, must be considered to constitute remuneration for a supply of services for consideration.

¹¹⁹² Case C-48/97, *Kuwait Petroleum*; see also, concerning the supply of services, Case C-16/93, *Tolsma*. In *Dixons Retail* I, the CJEU held that where products purchased with fraudulent bank cards were ultimately paid for by the card issuer under a guarantee scheme, there is still “consideration” for VAT purposes (Case C-494/12, *Dixons Retail*).

¹¹⁹³ Case 89/81, *Hong Kong Trade Development Council*.

¹¹⁹⁴ Case C-48/97, *Kuwait Petroleum*. However, the offering of retail vouchers to employees, in the context of a program designed to recognize and reward high-performing employees, does not constitute a supply of services for

¹¹⁸⁸ Case C-695/20, *Fenix International* (“Only Fans”).

wise, the counterpart of an economic transaction may also consist in a rebate or price discount on another symmetrical supply of goods or services, in which case the transaction remains within the scope of VAT.¹¹⁹⁵

There must be a direct and immediate link between the transaction concerned and the consideration received.¹¹⁹⁶ As indicated above, this requirement implies the existence of a legal relationship between the supplier and the purchaser entailing reciprocal performance, the price received by the supplier constituting the value actually given in return for the goods or services supplied.¹¹⁹⁷ However, if the consideration depends only in part on the actual value of the supply performed and for the most part, for example, on the income of the recipient, there is no economic activity.¹¹⁹⁸

The consideration for a supply of services may consist of a supply of goods, provided there is a direct link between the supply of services and the supply of goods and that the value of the latter can be expressed in monetary terms.¹¹⁹⁹ The same is true if a supply of goods is performed in exchange for a supply of services, as long as the same criteria are satisfied.¹²⁰⁰

b. Interaction Between VAT and Transfer Pricing

A particular focus of attention in the “for consideration” requirement is the interaction between VAT and transfer pricing.

Working Paper No. 923 — Possible VAT Implications of Transfer Pricing issued by the VAT Committee on February 28, 2017¹²⁰¹ seems to reflect a tension between the transfer pricing rules and the VAT rules. The transfer pricing rules are based on the arm’s length principle and seek to arrive at the arm’s length valuation of a transaction, i.e., the transaction’s open market value. The VAT rules base the consideration on a subjective value, i.e., the price actually paid. According to the VAT Committee, transfer pricing adjustments (upwards or downwards) may have VAT implications where the transfer pricing adjustment can be regarded as consideration given in exchange for

a taxable supply of goods or services already made, i.e., as an adjustment to a price already paid. This leads to a modification of the taxable amount of that transaction for VAT purposes. For there to be any VAT implications, the rules regarding the existence of a supply for consideration under Article 2(1) of the VATD would have to be met. In particular, a supply would have to be made in exchange for consideration and a direct link would have to be established between the supply and the consideration. Whether these criteria are satisfied would have to be assessed on a case-by-case basis.

*Weatherford Atlas Gip*¹²⁰² was the first CJEU decision on the interaction between VAT and transfer pricing. In essence, the case addressed the right to deduct VAT. The main question in the proceedings was whether an entity owned by Weatherford, Foserco, was able to deduct VAT paid on intra-company services, given that the services were also provided to other related companies in the group and it was questionable whether the supply of the services was necessary. The Court decided that it was up to the national courts to assess whether: (i) the intra-group services at issue were transactions subject to VAT; (ii) there was a direct link between these services and the consideration paid by the taxpayer; (iii) the company in question was a taxpayer within the meaning of the VATD; and (iv) the services had been used by the taxpayer for its own taxable transactions at a later stage. The CJEU affirmed that, while the tax authorities cannot deny a deduction simply based on the provision of a service not being necessary, the taxpayer must establish that all conditions for the applicability of VAT are fulfilled for it to be able to deduct input VAT.

A second case in which the CJEU ruled on the interplay between VAT and transfer pricing is *Höggkullen*,¹²⁰³ which centered around two questions: (i) whether an intra-group service always constitutes a unique service where there is no explicit comparable market value; and (ii) how the market value should be determined if the cost of providing the service will constitute the tax base. The CJEU held that the various services a holding company provides to its subsidiaries do not constitute a unique composite service. The Court considered that the services involved (business management, finance, property management, IT and personnel administration) were commonly available. All these services were available on the market and could be acquired separately. Thus, the market values of the various services should be determined based on a comparable price for each service. Referring to this conclusion (and its underlying reasoning), the CJEU added that there was no need to answer the second question.

The opinion rendered by Advocate General de la Tour of the CJEU in *Arcomet Towercranes*¹²⁰⁴ on April 3, 2025 endorsed the analysis set out in VAT Working Paper No. 923 referred to above. The Advocate General also concluded that the remuneration paid by a subsidiary to its parent company under a contractual arrangement, calculated in accordance with the OECD Transfer Pricing Guidelines and linked to the operating profit margin (i.e., a transaction-based net margin remuneration for intra-group services), constitutes consideration for a supply of services for VAT purposes under Article 2(1)(c) of the

consideration and thus is not subject to VAT (Case C-607/20, *GE Aircraft Engine Services*).

¹¹⁹⁵ Case 230/87, *Naturally Yours Cosmetics Ltd.*

¹¹⁹⁶ Case 154/80, *Coöperatieve Aardappelenbewaarplaats*; Case 102/86, *Apple and Pear Development Council*.

¹¹⁹⁷ Case C-48/97, *Kuwait Petroleum*; see also, concerning the supply of services, Case C-16/93, *Tolsma*.

¹¹⁹⁸ Case C-246/08, *Commission v. Finland* (public legal aid office services in return for a part contribution paid by the recipients).

¹¹⁹⁹ Case C-549/11, *Orfey*.

¹²⁰⁰ Case C-238/12, *Serebryannay vek*.

¹²⁰¹ <https://circabc.europa.eu/sd/a/55d34dce-faf8-42ba-8ec6-381a98540b9c/923%20-%20VAT%20Implications%20of%20Transfer%20Pricing.pdf>. The VAT Expert Group, set up by Commission Decision 2012/C 188/02 of June 26, 2012, was invited to opine on Working Paper No. 923. In its Paper issued on April 18, 2018 (<https://circabc.europa.eu/sd/a/96aa53b0-f2b6-4b06-b93a-9dd07bde6e51/945%20rev%20-%20aex%20-%20opinion%20of%20the%20vat%20expert%20group%20on%20transfer%20pricing.pdf>), the VAT Expert Group concluded that transfer pricing adjustments should be considered “Outside scope of VAT” where both parties have a full right to recover VAT. It is only when one of the traders does not have a full right of recovery, that transfer pricing adjustments might require a VAT adjustment if there is a sufficiently direct link between any payments resulting from an adjustment and specific supplies. Transfer pricing adjustments resulting from a tax audit should always be treated as outside of the scope of VAT unless the parties agree to change the consideration accordingly.

¹²⁰² Case C-527/23, *Weatherford Atlas Gip*.

¹²⁰³ Case C-808/23, *Höggkullen*.

¹²⁰⁴ Case C-726/23, *Arcomet Towercranes*.

VATD. It follows that transfer pricing adjustments, when directly linked to services supplied, fall within the scope of VAT. The Court added that to ensure that an input VAT deduction is warranted, the tax authorities retain the right to request additional evidence to the effect that services were actually supplied and used for purposes of making taxable supplies. While the tax authorities are not limited to an examination of the invoice itself, any evidence they require must be necessary and proportionate for purposes of assessing whether the substantive conditions for the right of deduction are fulfilled.

*Stellantis Portugal*¹²⁰⁵ concerns the VAT treatment of specific transfer pricing adjustments to achieve a minimum profit margin. On January 15, 2026, Advocate General Kokott issued her opinion stating that, if transfer pricing adjustments are agreed between parties and they specifically relate to earlier supplies of goods (as in the case at hand), such adjustments should be viewed as modifications to the taxable amount of the original supply. This has VAT consequences since the invoicing must be corrected. However, these price adjustments as such do not constitute a separate supply of services. The AG's opinion emphasizes that the potential VAT consequences of transfer pricing adjustments should always be analyzed based on a case-by-case assessment, i.e., for the purposes of VAT law, an adjustment of profits made for reasons of income tax law depends on what it relates to and how it is made. The CJEU's final decision is currently still pending.

Comment: For a comprehensive and coherent framework to be established in relation to this subject, in addition to VAT Committee Working Paper No. 923 (see above), it will be necessary for the CJEU to further clarify the interrelation between VAT, transfer pricing and intra-group services in its case law.

c. Relevance of “Direct and Immediate Link” in Terms of Right to Deduct

The relevance of the “direct and immediate link” principle concerns the right to deduct: it follows from the principle according to which goods or services acquired must have a direct and immediate link with taxable (taxed) transactions. The right to deduct the VAT charged on such goods or services presupposes that the expenditure incurred in obtaining them was part of the cost component of the taxable (taxed) transactions. Such expenditure must therefore be part of the costs of the output transactions that utilize the goods or services acquired.¹²⁰⁶ In this respect, only the objective relationship between the supplies performed and the taxable economic activity is decisive.¹²⁰⁷ It follows that, in the context of a business consisting, *inter alia*, in offering supplies of motor vehicles by hire purchase, even where the general costs relating to such supplies are passed on not in the amount due from the customer with respect to the supply of the goods concerned (i.e., the taxable part of the transaction), but in the amount of the interest due with respect to the “financing part” of the transaction (i.e., the exempt part of the transaction), those general costs must nonetheless be considered, for the purposes of VAT, to be a component of the

price of that supply.¹²⁰⁸ On the right to deduct, see the discussion at XVII.J., below.

d. Additional Points of Attention

Any technical difficulties that exist in determining the amount of consideration cannot by themselves justify the conclusion that no consideration exists.¹²⁰⁹

The VATD treats certain transactions for which no consideration is actually received by the taxable person as a supply of goods for consideration (see Article 16 of the VATD) or as a supply of services for consideration (see Article 26(1) of the VATD) (see, respectively, at XVII.D.1.a.(3) and 3.a.(1), above). The purpose of these provisions is to ensure equal treatment as between, on the one hand, a taxable person who applies goods or services for his or her own private use or for that of his or her staff and, on the other, a final consumer who acquires goods or services of the same type.¹²¹⁰

E. Place of Taxable Transactions

1. General

The rules on the place of supply in relation to taxable transactions falling within the territorial scope of the common system of VAT are codified in Articles 31 to 61 of the VATD. The place of supply and, hence, the place of taxation, varies depending on the transaction at issue, i.e., whether it is a supply of goods, an intra-EU acquisition, a supply of services or an importation of goods.

2. Place of Supply of Goods

a. Place of Supply of Goods That Are Not Dispatched or Transported

Where goods are not dispatched or transported, the place of supply is deemed to be the place where the goods are located at the time when the supply takes place.¹²¹¹ Such supplies are thus located in the Member State where the right to dispose of the goods is transferred.

b. Place of Supply of Goods That Are Dispatched or Transported

(1) Main Rule

Where goods are dispatched or transported by the supplier, the customer or a third person, the place of supply is deemed to be the place where the goods are located at the time when the dispatch or transportation of the goods to the customer begins.¹²¹² This “main” rule logically also applies to an intra-EU supply of goods.

¹²⁰⁸ Case C-153/17, *Volkswagen Financial Services* (interpreting the Court's statement in Case C-98/98, *Midland Bank Plc* that overhead costs “are part of the taxable person's general costs and are, as such, components of the price of an undertaking's products”).

¹²⁰⁹ Case C-410/17, *A Oy* (referring, by analogy, to Case C-172/96, *First National Bank of Chicago*).

¹²¹⁰ Case C-607/20, *GE Aircraft Engine Services*.

¹²¹¹ VATD, Art. 31.

¹²¹² VATD, Art. 32, first para.

¹²⁰⁵ C-603/24, *Stellantis Portugal*.

¹²⁰⁶ Case C-98/98, *Midland Bank Plc*.

¹²⁰⁷ Case C-277/09, *RBS Deutschland Holdings*; Case C-104/12, *Finanzamt Köln-Nord v. Wolfgang Becker*.

(2) Derogations from Main Rule

If the dispatch or transportation of the goods begins in a third territory or third country, both the place of supply by the importer designated or recognized as liable for payment of VAT and the place of any subsequent supply are deemed to be within the Member State of importation of the goods.¹²¹³ This allocation rule concerns “triangulation” or “ABC” transactions, where A supplies B, who in turn supplies C, with the goods moving directly from A to C and A importing the goods directly into the European Union. Absent such a rule, B and C could argue — based on the main rule set out in XVII.E.2.b.(1), above — that the supply of goods took place in the country of departure (i.e., the place where the goods were located at the time when the dispatch or transportation of the goods to the customer began) and, thus, outside the European Union.

Further derogations from the main rule apply as follows:¹²¹⁴

(i) In the case of intra-EU distance sales of goods, the place of supply is the place where the goods are located at the time when dispatch or transport of the goods to the customer ends (Article 33(a) of the VATD). For the definition of “intra-EU distance sales of goods,” see XVII.D.1.a.(2), above.

(ii) In the case of distance sales of goods imported from third territories or third countries into a Member State other than that in which dispatch or transport of the goods to the customer ends, the place of supply is the place where the goods are located at the time when dispatch or transport of the goods to the customer ends (Article 33(b) of the VATD). For the definition of “distance sales of goods imported from third territories or third countries,” see XVII.D.1.a.(2), above.

(iii) In case of distance sales of goods imported from third territories or third countries into the Member State in which dispatch or transport of the goods to the customer ends, the place of supply is in that Member State, provided that VAT on those goods is to be declared under the special scheme for distance sales of goods imported from third territories or third countries (Article 33(c) of the VATD) (see, XVII.L.6.d., below).

None of the above derogations apply to supplies of second-hand goods, works of art, collectors’ items or antiques, as defined in points (1) to (4) of Article 311(1) of the VATD, or to supplies of second-hand means of transport, as defined in Article 327(3) of the VATD) subject to VAT in accordance with the relevant special arrangements.¹²¹⁵

The general place-of-supply rule for intra-EU distance sales of goods set out above in (i) (i.e. taxation in the Member State to which the goods are dispatched or transported (Article 33(a)) does not apply where the requirements of Article 59c(1) of the VATD¹²¹⁶ are met, i.e., where: (i) the supplier is estab-

lished or, in the absence of an establishment, has its permanent address or usually resides only in one Member State; (ii) the services are supplied to non-taxable persons who are established, have their permanent address or usually reside in any Member State other than the Member State referred to in (i) or goods are dispatched or transported to a Member State other than the Member State referred to in point (i); and (iii) the total value, exclusive of VAT, of the supplies referred to in (ii) neither exceeds a threshold of 10,000 euros or the equivalent in national currency (the corresponding value in national currency is to be calculated by applying the exchange rate published by the European Central Bank on the date of adoption of Directive (EU) 2017/2455) in the current calendar year nor did so in the preceding calendar year. In these circumstances, Article 59c(1) provides that the intra-EU distance sale is subject to VAT in the Member State in which the supplier is established (meaning that intra-EU distance sales of goods up to 10,000 euros are subject to the same VAT treatment as domestic supplies). However, the supplier may decide not to apply the 10,000-euros threshold and to apply the general place-of-supply rule of Article 33(a) (i.e., taxation in the Member State to which the goods are dispatched or transported).¹²¹⁷ In any event, as soon as the annual 10,000-euros threshold is exceeded during a calendar year, the general place-of-supply rule of Article 33(a) re-enters in force as of that time.¹²¹⁸

(3) Installed or Assembled Goods

Where goods dispatched or transported by the supplier, by the customer or by a third person are installed or assembled, with or without a trial run, by or on behalf of the supplier, the place of supply is the place where the goods are installed or assembled.¹²¹⁹ This rule prevents goods from being sold, for example, in a third country, against the zero rate, for a price that includes the costs of installation, while, on importation, VAT is only payable on the value of the goods, i.e., exclusive of the costs of installation. Where the installation or assembly is carried out in a Member State other than that of the supplier, the Member State within whose territory the installation or assembly is carried out is obliged to take the steps necessary to ensure that there is no double taxation in that Member State.¹²²⁰

(4) Chain Transactions

Generally, chain transactions are transactions in which goods are successively sold between various parties of two or more Member States and are delivered by way of a single transportation movement from a seller higher in the chain to the last purchaser.

Chain transactions have the potential to result in VAT complications if cross-border transportation is involved, since the question then arises as to how the single transportation movement is to be allocated to (one of) the various supplies in the chain. An important body of case law of the CJEU has evolved on this issue, the red line being the CJEU’s suggestion that the single transportation movement should be ascribed to one of the successive supplies, which would then be able

¹²¹³ VATD, Art. 32, second para.

¹²¹⁴ VATD, Art. 33.

¹²¹⁵ VATD, Art. 35.

¹²¹⁶ Art. 59c was inserted in the VATD by Council Directive (EU) 2017/2455 of December 5, 2017 amending Directive 2006/112/EC and Directive 2009/132/EC as regards certain value added tax obligations for supplies of services and distance sales of goods.

¹²¹⁷ VATD, Art. 59c(3).

¹²¹⁸ VATD, Art. 59c(2).

¹²¹⁹ VATD, Art. 36, first para.

¹²²⁰ VATD, Art. 36, second para.

to benefit from the exemption in Article 138 of the VATD for intra-EU supplies (see, XVII.I.3.a.(1), below), rather than to those supplies equally.¹²²¹

In *Euro Tyre*,¹²²² the CJEU held that if goods are subjected to two successive supplies between different taxable persons acting as such, but only one intra-EU transportation occurs, the transaction to which this transportation is to be allocated (i.e., the first or second supply), with the result that the transaction concerned comes within the definition of an intra-EU supply, is dependent on an overall assessment of all the specific circumstances from which it is possible to determine which supply meets all the requirement relating to an intra-EU supply. In the circumstances in which the first recipient, which has obtained the power in the territory of the Member State of the first supply to dispose of the goods as their owner, has expressed its intention to transport these goods to another Member State and has identified itself with the VAT identification number allocated to it by the latter Member State, the intra-EU transportation, in the Court's opinion, must be allocated to the first supply. This is subject to the condition that the power to dispose of the goods as their owner was transferred to the second recipient in the Member State of destination of the intra-EU transportation.¹²²³

In *Fonderie 2A*,¹²²⁴ the CJEU decided that the place of supply of goods sold by a company established in a Member State to a person established in another Member State, and on which the vendor, to make the goods fit to be supplied, has had finishing work carried out by a service provider established in that other Member State, before having them dispatched by the service provider to the person to which they are being supplied, must be deemed to be in the Member State where the latter is established.¹²²⁵ Arguably, the CJEU's approach was somewhat

academic in the sense that, in practice, not all parties in the chain are necessarily fully aware of "all the specific circumstances" required to make an "overall assessment" and, thus, may be unable to identify the appropriate VAT treatment to be applied.

Against this backdrop, Council Directive (EU) 2018/1910 of December 4, 2018 amending Directive 2006/112/EC as regards the harmonization and simplification of certain rules in the value added tax system for the taxation of trade between Member States, as one of the "quick fixes" (see the discussion at XVII.P., below), inserted Article 36a in the VATD. Chain transactions within the meaning of Article 36a are successive supplies of the same goods (meaning that there are two or more consecutive supplies) where the goods supplied are subject to a single intra-EU transport between two Member States.

According to the general rule laid down in Article 36a(1) of the VATD, where the same goods are supplied successively and those goods are dispatched or transported from one Member State to another Member State directly from the first supplier to the last customer in the chain, the dispatch or transport is ascribed only to the supply made to the intermediary operator.

However, Article 36a(2) of the VATD provides for the possibility of derogating from the general rule. This will apply when the intermediary operator communicates to its supplier the VAT identification number issued by the Member State from which the goods are dispatched or transported. In this case, the dispatch or transport of the goods is ascribed to the supply made by the intermediary operator.

For these purposes, "intermediary operator" means a supplier within a chain other than the first supplier in the chain that dispatches or transports the goods either itself or through a third party acting on its behalf. By way of derogation, the dispatch or transport must be ascribed only to the supply of goods by the intermediary operator where the intermediary operator has communicated to its supplier the VAT identification number issued to it by the Member State from which the goods are dispatched or transported.

As indicated, for Article 36a of the VATD to apply, the following conditions have to be fulfilled:

- (i) The goods must be supplied successively. It is therefore necessary for at least three persons to be involved in the chain transaction.
- (ii) The goods must be dispatched or transported from one Member State to another.

of VAT would be the Member State of the service provider, where the supplier would be eligible for the tax exemption for intra-EU supplies of goods. There may, therefore, be an incentive for suppliers to use service providers in their own Member State to avoid having to fulfill tax obligations in another Member State. The alternative would be that every cross-border transportation or dispatch of goods in an ongoing production process that has as its ultimate end point delivery to the person acquiring the goods could potentially qualify for the tax exemption applicable to intra-EU supplies. However, this would have the effect of causing the close temporal link between the cross-border transportation or dispatch, which would trigger the tax exemption, on the one hand, and the declaration of an intra-EU acquisition by the person acquiring the goods, on the other, to be lost. The loss of that link could be seriously deleterious to the supervision of intra-EU trade, in particular where this serves to prevent fraud.

¹²²¹ See, e.g., Case C-245/04, *EMAG*. The CJEU held that, even if two successive supplies give rise to only a single movement of goods, they must be regarded as having followed each other in time. The intermediary acquiring the goods can transfer the right to dispose of the goods as owner to the second person acquiring the goods only if that right has previously been transferred to it by the first vendor and, therefore, the second supply can take place only after the first supply has been effected. As the place of acquisition of the goods by the intermediary is deemed to be in the Member State of arrival of the dispatch or transportation of those goods, it would be illogical for that taxable person to be deemed to have made the subsequent supply of those same goods from the Member State of the departure of that dispatch or transportation.

¹²²² Case C-430/09, *Euro Tyre*.

¹²²³ See also Case C-386/16, *Toridas*, in which the CJEU made it clear that the processing of the supplied goods does not form part of the substantive conditions laid down by VATD, Art. 138(1) (exemption for intra-EU supplies; see XVII.I.3.a.(1)) — as regards a chain of two supplies, the first supply could not be classified as an intra-EU supply since no intra-EU transport could be ascribed to it. Thus, the processing of goods in the course of a chain of two successive supplies carried out on the instructions of the middleman acquiring the goods and before the goods are transported to the Member State of the person finally acquiring them, has no effect on the conditions for any exemption of the first supply where that processing takes place after the first supply.

¹²²⁴ Case C-446/13, *Fonderie 2A*.

¹²²⁵ In her Opinion in Case C-446/13, *Fonderie 2A*, Advocate General Kokott (also) reached the conclusion that an adequate material link between the dispatch of the goods and their supply therefore arises only where the goods are dispatched to the person acquiring them in the condition stipulated by the contract. She added, however, that this solution raises problems from the point of view of the functioning of the internal market, as the supplier can then avoid the administrative burdens associated with taxation in its Member State by choosing a service provider in another Member State and dispatching (in the case at issue) the metal parts to the person acquiring them in the supplier's Member State from there. In that event, the place of supply of the goods for purposes

(iii) The goods must be transported or dispatched directly from the first supplier to the last customer in the chain.

Chain transactions involving imports and exports, or involving only supplies within the territory of a Member State, are not covered by Article 36a of the VATD. Nor do the Article 36a allocation rules apply to situations involving “deemed supplier” online platforms covered by Article 14a of the VATD (see XVII.D.1.a.(2), above and XVII.D.1.a.(5), above).

Examples of the operation of Article 36a of the VATD are set out in the December 2019 Commission’s Explanatory Notes on the EU VAT changes with respect to call-off stock arrangements, chain transactions and the exemption for intra-EU supplies of goods (“2020 Quick Fixes”), pages 46–50 and 54–60.¹²²⁶

(5) “Deemed Supplier” Online Platforms

Under the “deemed supplier” rule of Article 14a of the VATD, which applies to qualifying online platforms, the underlying (single) supply is split into a business-to-business supply followed by a business-to-consumer supply (see, XVII.D.1.a.(2), above). It is therefore necessary to determine to which of those supplies the dispatch or transport of the goods should be ascribed to enable proper determination of their place of supply.

Article 36b of the VATD addresses this issue by providing that where a taxable person is deemed to have received and supplied goods in accordance with Article 14a, the dispatch or transport of the goods is ascribed to the supply made by that taxable person.¹²²⁷ In other words, Article 36b introduces a legal fiction attributing the transport of the goods to the supply by the platform to the customer (thus giving the platform a pivotal role for VAT compliance purposes).

c. Place of Supply of Goods on Board Ships, Aircraft or Trains

Where goods are supplied on board a ship, an aircraft or a train during the section of a passenger transport operation effected within the European Union, the place of supply is deemed to be at the point of departure of the passenger transport operation.¹²²⁸

For this purpose, “section of a passenger transport operation effected within the European Union” means the section of the operation effected, without a stopover outside the European Union, between the point of departure and the point of arrival of the passenger transport operation. “Point of departure of a passenger transport operation” means the first scheduled point of passenger embarkation within the European Union, after a stopover outside the European Union where applicable. “Point of arrival of a passenger transport operation” means the last scheduled point of disembarkation within the European Union of passengers who embarked in the European Union, before a stopover outside the European Union where applicable. In the

¹²²⁶ https://taxation-customs.ec.europa.eu/system/files/2021-08/explanatory_notes_2020_quick_fixes_en.pdf.

¹²²⁷ VATD, Art. 36b was inserted in the VAT Directive by Council Directive (EU) 2019/1995 of November 21, 2019 amending Directive 2006/112/EC as regards provisions relating to distance sales of goods and certain domestic supplies of goods.

¹²²⁸ VATD, Art. 37.

case of a return trip, the return leg will be regarded as a separate transport operation.

Pending the adoption of Commission proposals on the place of taxation of the supply of goods for consumption on board and the supply of services, including restaurant services, for passengers on board ships, aircraft or trains, Member States may exempt or continue to exempt, with the VAT paid at the preceding stage being deductible, the supply of goods for consumption on board with respect to which the place of taxation is determined in accordance with the rule set out above.

d. Place of Supply of Gas, Electricity, Heat and Cooling Energy through Networks

In the case of: (i) the supply of gas through a natural gas system situated within the territory of the European Union or any network connected to such a system; (ii) the supply of electricity; or (iii) the supply of heat or cooling energy through heating or cooling networks to a taxable dealer, the place of supply is deemed to be the place where the taxable dealer has established its business or has a fixed establishment for which the goods are supplied or, in the absence of such a place of business or fixed establishment, the place where the taxable dealer has its permanent address or usually resides.¹²²⁹ “Taxable dealer” means a taxable person whose principal activity with respect to purchases of gas, electricity, heat or cooling energy is reselling those products and whose own consumption of those products is negligible.

In the case of the supply of gas through a natural gas system situated within the territory of the European Union or any network connected to such a system, the supply of electricity or the supply of heat or cooling energy through heating or cooling networks, where such a supply is not covered by Article 38 of the VATD, the place of supply is deemed to be the place where the customer effectively uses and consumes the goods. Where all or part of the gas, electricity or heat or cooling energy is not effectively consumed by the customer, the non-consumed goods are deemed to have been used and consumed at the place where the customer has established its business or has a fixed establishment for which the goods are supplied. In the absence of such a place of business or fixed establishment, the customer is deemed to have used and consumed the goods at the place where the customer has a permanent address or usually resides.¹²³⁰

3. Place of Intra-European Union Acquisition of Goods

a. Applicable Rules

Under Article 40 of the VATD, the place of an intra-EU acquisition of goods is the place where the dispatch or transportation of the goods to the person acquiring them ends.

By way of exception (and unless the simplification measures for intra-EU triangulation apply — see XVII.E.3.b., below), the place of an intra-EU acquisition of goods is deemed to be within the territory of the Member State that issued the VAT identification number under which the person acquiring the goods made the acquisition, unless the person acquiring the

¹²²⁹ VATD, Art. 38.

¹²³⁰ VATD, Art. 39.

goods establishes that VAT has been applied to that acquisition in accordance with Article 40 of the VATD.¹²³¹ If VAT is so applied to the acquisition and subsequently applied, under Article 40, to the acquisition in the Member State in which the dispatch or transportation of the goods ends, the taxable amount must be reduced accordingly in the Member State that issued the VAT identification number under which the person acquiring the goods made the acquisition.¹²³²

b. Simplification Measures for Intra-European Union Triangulation

In the case of triangulation transactions in which the single transportation movement is ascribed to the first supply, Article 42 of the VATD provides for simplification measures.

Under these measures, an intra-EU acquisition is taxed in the Member State of destination and not in the Member State of identification, if: (i) the person acquiring the goods establishes that it made the intra-EU acquisition for purposes of a subsequent supply within the territory of the Member State identified in accordance with Article 40, for which the person to which the supply is made (i.e., the consignee) has been designated (in accordance with Article 197) as liable for the payment of VAT (the “reverse charge mechanism”); and (ii) the person acquiring the goods has complied with the obligations (laid down in Article 265) relating to the submission of the “recapitulative statement”¹²³³ (with effect from 1993, every taxable person identified for VAT purposes must submit a “recapitulative statement” indicating the persons acquiring goods identified for VAT purposes to which the taxable person has made intra-EU supplies of goods; this is also known as the “intra-EU sales list”).

The underlying policy objective is that the place of taxation should be the Member State to which the goods are delivered. If traders could simply account for, and recover, acquisition tax in their own Member State of registration, they would no longer have any incentive to establish that the intra-EU acquisition in question had been taxed in the Member State of arrival of the dispatch or transportation.¹²³⁴

In *Firma Hans Bühler*,¹²³⁵ the CJEU expressly distinguished between the conditions of point (a) and point (b) of Article 42. Point (b) refers to a corresponding tax return (the recapitulative statement). The Court described that as an arrangement that “must be regarded as being formal.” However, the relevant condition referred to in point (a), requiring an invoice referring to a reverse charge (“for which the person to whom the supply is made has been designated in accordance with Article 197 as liable for payment of VAT”), should be regarded as a “basic condition.”

This is further illustrated in *Luxury Trust Automobil*,¹²³⁶ in which the CJEU held that Party B could only apply the simplified triangulation scheme in cross-border supply chains of goods if the invoices issued by Party B to Party C stated that the reverse charge mechanism applied. Failure to include this state-

ment on the invoice cannot be corrected (retrospectively) by issuing a new invoice with the correct statement. If Party B did not state that the reverse charge mechanism applied on its invoice, the triangulation scheme could not be applied, which increased the VAT-compliance burden for Party B in cross-border chain supplies.

4. Place of Supply of Services

a. Two “Default” Rules

There are two “default” rules for determining the place of supply of services, the appropriate rule depending on whether business-to-business (B2B) or business-to-consumer (B2C) supplies of services are involved. The primary aim of these rules is, where possible, to levy VAT where actual consumption takes place.

As regards B2B supplies of services,¹²³⁷ i.e., supplies of services to a taxable person “acting as such,” the place of supply is the place where that person has established its business. However, if such services are provided to a fixed establishment of the taxable person located in a place other than the place where it has established its business, the place of supply of the services will be the place where the fixed establishment is located. In the absence of such a place of establishment or fixed establishment, the place of supply of services will be the place where the taxable person receiving the services has its permanent address or usually resides. It is noteworthy, in the CJEU’s opinion, that the place of supply does not change if the recipient of the service committed VAT evasion.¹²³⁸

As regards B2C supplies of services¹²³⁹ (i.e., supplies of services to a non-taxable person), the place of supply is the place where the supplier has established its business. However, if the services are provided from a fixed establishment of the supplier located in a place other than the place where it has established its business, the place of supply of the services will be the place where the fixed establishment is located. In the absence of such a place of establishment or fixed establishment, the place of supply of services will be the place where the supplier has its permanent address or usually resides.

For these purposes, the VAT Implementing Regulation specifies¹²⁴⁰ that the place where the business of a taxable person is established is the place where the functions of the business’s central administration are carried out. To determine this, account must be taken of the place where essential decisions concerning the general management of the business are taken, the place where the registered office of the business is located and the place where the management meets. Where these criteria do not allow the place of establishment of a business to be determined with certainty, the place where essential decisions concerning the general management of the business are made takes precedence. A mere postal address may not be taken to be the place of establishment of the business of a taxable person.

The VATD does not provide a definition of the concept of “fixed establishment.” According to the VAT Implementing

¹²³¹ VATD, Art. 41, first para.

¹²³² VATD, Art. 41, second para.

¹²³³ VATD, Art. 42.

¹²³⁴ See, e.g., Joined Cases C-536/08 and C-539/08, *Facet*.

¹²³⁵ Case C-580/16, *Firma Hans Bühler*.

¹²³⁶ Case C-247/21, *Luxury Trust Automobil*.

¹²³⁷ VATD, Art. 44.

¹²³⁸ Case C-641/21, *Climate Corporation Emissions Trading*.

¹²³⁹ VATD, Art. 45.

¹²⁴⁰ VAT Implementing Regulation, Art. 10.

Regulation,¹²⁴¹ a “fixed establishment” is any establishment, other than the place of establishment of a business (see above), characterized by a sufficient degree of permanence and a suitable structure in terms of human and technical resources to enable it to receive and use the services supplied to it for its own needs or to provide the services that it supplies. The possession of a VAT identification number is not in itself sufficient for a taxable person to be considered to have a fixed establishment. This definition of “fixed establishment” has clearly been derived from CJEU case law, although it does not reflect two other elements typically considered by the CJEU in determining whether there is a “fixed establishment,” i.e.: (i) the fixed establishment must be fully dependent on the taxable person’s main office; and (ii) treating the taxable person’s presence as a fixed establishment must produce a “rational result (for tax purposes)” in keeping with the underlying actual economic situation.¹²⁴² For example, in *Cabot Plastics Belgium*,¹²⁴³ the CJEU held that a subsidiary exclusively providing toll manufacturing services to another group company acting as principal should not constitute a fixed establishment of that principal where: (i) the subsidiary is acting for its own risk and account and remains responsible for the staff and resources it uses; and (ii) the principal cannot dispose of the staff and resources of the subsidiary as its own. Evidently, terms such as “sufficient degree of permanence” and “suitable structure” leave considerable room for interpretation and appreciation by the individual

¹²⁴¹ VAT Implementing Regulation, Art. 11.

¹²⁴² See, *inter alia*, Case C-190/95, *ARO Lease*; Case C-390/96, *Lease Plan Luxembourg*. See also Case C-605/12, *Welmorey*. A property that is let in a Member State, where the owner of that property does not have his or her own staff to perform services relating to the letting, does not constitute a fixed establishment for VAT purposes (Case C-931/19, *Titanium*). The existence, in the territory of a Member State, of a fixed establishment of a company established in a non-member state may not be inferred by a supplier of services from the mere fact that the company has a subsidiary in that state (Case C-547/18, *Dong Yang Electronics*). In Case C-333/20, *Berlin Chemie*, the CJEU reiterated that a company that has its registered office in one Member State does not have a fixed establishment in another Member State solely on the grounds that the company has a subsidiary in that State that makes available to it human and technical resources under contracts providing for the subsidiary to make available, exclusively to it, marketing, regulatory, advertising and representation services that are capable of having a direct influence on the volume of its sales. The CJEU also clarified the definition of fixed establishment in Implementing Regulation No 282/2011, Art. 11(1) by emphasizing that the existence of a suitable structure in terms of human and material resources that display a sufficient degree of permanence must be established in light of the economic and commercial reality. According to the Court, although it is not a requirement for a taxable person itself to own the human or technical resources for that taxable person to be regarded as having a sufficiently permanent and appropriate structure — in terms of human and technical resources — in another Member State, it is necessary for that taxable person to have the right to dispose of those human and technical resources in the same way as if they were its own (e.g., under employment and leasing contracts that make those resources available to the taxable person and cannot be terminated at short notice). The CJEU thus tends to interpret the concept of a fixed establishment for VAT purposes quite strictly.

¹²⁴³ Case C-232/22, *Cabot Plastics Belgium*. The case involved two entities in the same group: Cabot Switzerland GmbH, acting as principal; and Cabot Plastics Belgium. Cabot Plastics Belgium provided toll manufacturing services to the principal, as well as various logistic support services. It used its own resources and staff to transform raw materials belonging to the principal into finished plastic products and the logistic support services were also carried out exclusively for the principal. Cabot Plastics Belgium invoiced its services to the Swiss principal without Belgian VAT. This omission was contested by the Belgian VAT authorities, who claimed that the Swiss principal had a fixed establishment in Belgium through Cabot Plastics Belgium.

Member States and, consequently, mutually conflicting positions are not entirely ruled out.

In what is perceived as constituting a definitive position on this matter, the CJEU in *SC Adient*¹²⁴⁴, in line with *Dong Yang Electronics*, *Berlin Chemie* and *Cabot Plastics Belgium* (see above), (re-)affirmed¹²⁴⁵ that the mere fact that a local group company renders services to a foreign group company does not in itself constitute a fixed establishment for VAT purposes.

SC Adient concerned an arrangement under which Adient Germany engaged Adient Romania as a toll manufacturer to produce automotive products. The ownership of the raw materials and finished products remained with Adient Germany. Adient Germany sold the finished products to customers. Adient Romania manufactured and assembled the products for Adient Germany. Adient Romania also rendered auxiliary services to Adient Germany. These auxiliary services included stock management and support with the shipping of finished products.

Based on this fact pattern, the CJEU held that the acquisition of toll manufacturing services from a related party does not lead to the creation of a fixed establishment. Specifically, a VAT payer established in one Member State that obtains services provided by a company established in another Member State, cannot be regarded as having a fixed establishment in that other State solely because the two companies belong to the same group or are bound by a contract for the provision of services. Neither the fact that a VAT payer established in one Member State receiving manufacturing services provided by a company established in another Member State has a structure in that other State that intervenes in the supply of the finished products arising from those manufacturing services, nor the fact that those supply transactions are carried out mostly outside that State and that those carried out there are subject to VAT, are relevant to establishing, for the purposes of determining the place of supply of services, that the VAT payer has a fixed establishment in that other State. Finally, a VAT payer established in one Member State receiving services provided by a company established in another Member State, does not have a fixed establishment in that other State if its technical and human resources in that State are not distinct from those by which the services are supplied to it, or if those human and technical resources perform only preparatory or auxiliary activities.

This ruling should put an end to the broad interpretation of the “VAT fixed establishment” concept as applied by some Member States’ tax authorities in corporate group structures, i.e., where the tax authorities seek to establish a place of supply for cross-border services that would create a VAT liability within their jurisdiction, they may not engineer a fixed establishment from the existence of a parent-subsidiary relationship (*Dong Yang*), the outsourcing of services (*Berlin Chemie*), an exclusive customer base (*Cabot Plastics*), or shared infrastructure or considerations of company law (*SC Adient*).

The “permanent address” of a natural person, whether or not a taxable person, is the address entered in the population or similar register, or the address indicated by that person to the relevant tax authorities, unless there is evidence that this ad-

¹²⁴⁴ Case C-533/22, *SC Adient*.

¹²⁴⁵ The CJEU expressly emphasized that it was repeating itself.

dress does not reflect reality.¹²⁴⁶ The place where a natural person “usually resides,” whether or not a taxable person, is the place where that natural person usually lives as a result of personal and occupational ties. Where the occupational ties are in a country different from that of the personal ties, or where no occupational ties exist, the place of usual residence is to be determined by personal ties that show close links between the natural person and a place where he or she is living.¹²⁴⁷

b. Particular Provisions

The default rules on the place of supply of services discussed in XVII.E.4.a., above, are subject to numerous exceptions. These are set out in Articles 46 to 59 of the VATD (as further specified in Articles 30 to 41 of the VAT Implementing Regulation) and are discussed in XVII.E.4.b.(1) to (9), below.

(1) Supply of Services by Intermediaries

The place of supply of services rendered to a non-taxable person by an intermediary acting in the name and on behalf of another person is the place where the underlying supply (i.e., either a supply of goods or a supply of services) is made in accordance with the VATD.¹²⁴⁸

(2) Supply of Services Connected with Immovable Property

The place of supply of services connected with immovable property is the place where the immovable property is located.¹²⁴⁹ The CJEU tends to adopt a rather broad interpretation of the concept of “services connected with immovable property.”¹²⁵⁰

On October 26, 2015, the European Commission issued explanatory notes on the place of supply rules for services connected with immovable property, which entered into force in 2017 (the “Explanatory Notes”).¹²⁵¹

¹²⁴⁶ VAT Implementing Regulation, Art. 12.

¹²⁴⁷ VAT Implementing Regulation, Art. 13.

¹²⁴⁸ VATD, Art. 46; VAT Implementing Regulation, Arts. 30–31.

¹²⁴⁹ VATD, Art. 47. As a “particular” rule (since the rule implies a departure from the principle that for VAT purposes every supply must normally be regarded as distinct and independent (see Case C-392/11, *Field Fisher Waterhouse*; Case C-111/05, *Aktiebolaget NN*; Case C-461/08, *Don Bosco Onroerend Goed*; and Case C-276/09, *Everything Everywhere*)), VATD, Art. 47 is not an exception to the general place of supply rules contained in VATD, Arts. 44 (B2B) and 45 (B2C) (see, e.g., Case C-166/05, *Heger Rudi* and Case C-41/04, *Levob Verzekeringen and OV Bank*), and, hence, the criterion of strict interpretation does not apply to the definition of services connected with immovable property. Rather, Art. 47 should be applied based on an objective assessment of the conditions provided under the VATD and the VAT Implementing Regulation. It should first be verified whether the services fall within the scope of the particular rule of Art. 47 (Case C-155/12, *RR Donnelley Global Turnkey Solutions Poland*); if they do so fall, the services will be considered connected with immovable property. If they do not and no other particular rule applies, the general rules of Arts. 44 and 45 will apply. In some circumstances, it can happen that the conditions for the application of two or more particular rules are fulfilled. In such cases, the rule that better ensures taxation at the presumed place of consumption should be applied (Case C-37/08, *RCI Europe*).

¹²⁵⁰ See, *inter alia*, Case C-37/08, *RCI Europe* (timeshare exchange programs); Case C-270/09, *Macdonald Resorts Limited* (acquisition of timeshare usage rights).

¹²⁵¹ The Explanatory Notes state that they are not legally binding and do not prevent Member States and national tax administrations from adopting national guidance on the same subject matter, nor are they comprehensive. The objective of the Explanatory Notes is to provide a better understanding of EU legislation, mainly Council Implementing Regulation (EU) No. 1042/2013 of

Under Article 47 of the VATD, in the case of a single bundled supply,¹²⁵² the predominant element of the supply must be identified and it must then be established whether this predominant element is connected with immovable property. To be considered connected with immovable property, a service must have a sufficiently direct connection with immovable property.¹²⁵³ Therefore, what should first be assessed is whether the service relates to a good that can qualify as immovable property.

Article 13b of the VAT Implementing Regulation defines¹²⁵⁴ “immovable property” by reference to four categories.¹²⁵⁵

The four categories are:

- (i) Any specific part of the earth, on or below its surface, over which title and possession can be created;¹²⁵⁶
- (ii) Any building or construction fixed to or in the ground above or below sea level that cannot be easily dismantled or moved;¹²⁵⁷
- (iii) Any item that has been installed and makes up an integral part of a building or construction without which the building or construction is incomplete, such as a door, window, roof, staircase or lift;¹²⁵⁸ and

October 7, 2013, amending Implementing Regulation (EU) No. 282/2011 as regards the place of supply of services. The Explanatory Notes can be seen as guidance to be used to clarify the practical impact of the EU VAT legislation on services connected with immovable property. The Explanatory Rules are a work-in-progress in that they reflect the state of play at a specific point in time in accordance with the knowledge and experience available.

¹²⁵² On the concept of a “bundled” or “composite” supply, see XVII.D.1.d.

¹²⁵³ The connection between the service and the immovable good must be “sufficient” and not merely tenuous (Case C-166/05, *Rudi Heger*).

¹²⁵⁴ This definition is largely inspired by the CJEU’s decision in Case C-428/02, *Fonden Marselisborg Lystbadehavn*.

¹²⁵⁵ This definition is largely inspired by the CJEU’s decision in Case C-428/02, *Fonden Marselisborg Lystbadehavn*.

¹²⁵⁶ What needs to be verified is whether the immovable property is likely to be “owned” in the sense that somebody can dispose of it as if that person were the owner, so that the concept of ownership goes beyond the simple fact of owning a title (see, e.g., Case C-320/88, *Shipping and Forwarding Enterprise Safe*, Case C-25/03, *HE*, and Case C-88/09, *Graphic Procede*; see also, XVII.D.1.b.).

¹²⁵⁷ Case C-315/00, *Rudolf Maierhofer* (structures fixed to or in the ground must be regarded as immovable property; in that connection, it is significant that structures cannot be easily dismantled or easily moved, but there is no need for them to be inseparably fixed to or in the ground); see also Case C-532/11, *Leichenich*. Whether a building is complete or not (e.g., when it has no roof or windows like an ancient monument), it will still be covered by VATD, Art. 13b provided it is fixed to or in the ground. This will also be the case with buildings that are in the process of being constructed; they become immovable property as the construction works are carried out and the structure is being fixed to or in the ground.

¹²⁵⁸ According to the Explanatory Notes, “integral” means that, without the item concerned, the building or construction would be incomplete. The effect of this provision is to treat any item that would otherwise be a movable good, as immovable property by the sole fact of it making up an integral part of a building or construction. The examples in VATD, Art. 13b(c) form part of the finishing elements without which some buildings or constructions would be seen as incomplete. Insofar as those elements contribute to completing the main structure of the building or construction so that it can be used for the purpose it has been designed for, they will be considered immovable property. To the examples in Art. 13b(c), could be added the finishing construction elements that are placed on the structural system such as insulation, partition walls, and wall and floor coverings; the same applies to electrical, sanitary, ventilation or heat installations other than the main installations that would be covered under Art. 13b.

(iv) Any item, equipment or machine permanently installed in a building or construction that cannot be moved without destroying or altering the building or construction.¹²⁵⁹

This list of four categories is exhaustive. However, these categories should not be regarded as mutually exclusive, meaning that some goods may be covered by more than one category. To determine whether a service is connected with immovable property, it is essential to verify whether it relates to at least one of those four categories.

The fact that a good can qualify as immovable property under one or more categories of the definition does not mean that all services involving this type of good will have to be considered connected with immovable property. Only those services having a “sufficiently direct connection with that property” will be treated as connected with immovable property for VAT purposes. Article 31a of the VAT Implementing Regulation is designed to facilitate the identification of services connected with immovable property as defined in Article 47 of the VATD.

Article 31a(1) provides guidance on what qualifies as a service connected with immovable property. Article 31a(2) gives a list of examples of services that are to be regarded as connected with immovable property and are, therefore, covered by Article 47. Article 31a(3) presents a list of examples of services that are not to be regarded as connected with immovable property and that are, therefore, not covered by Article 47. The lists under Articles 31a(2) and 31a(3) are purely indicative, implying that any specific situation that has not been explicitly covered by Article 31a(2)(a) to (q) or by Article 31a(3) should be assessed on a case-by-case basis against the criteria set out in Article 31a(1).

According to the Explanatory Notes, to determine whether a service is to be regarded as connected with immovable property, the following steps should be taken:

- (i) Check whether the service is included under Article 31a(2) of the VAT Implementing Regulation — if yes, it is covered by Article 47 of the VATD;
- (ii) Examine whether the service is excluded from the application of Article 47 under Article 31a(3);
- (iii) If the service cannot be found on either of these two lists, verify whether it satisfies any of the criteria set out under Article 31a(1).¹²⁶⁰

¹²⁵⁹ The effect of this provision is to treat any item that would otherwise be a movable good as immovable property by virtue of the sole fact that it is permanently installed in a building or construction in such a way that it cannot be moved without destroying or altering the building or construction. What is decisive is whether the removal of an item installed in such a way as to last in a building or construction would cause certain damage to the building or construction. The destruction and alteration of a building or construction, within the meaning of VATD, Art. 13b(d), refers to both the portion of the building or construction to which the item is attached and to the rest of the building or construction. “Destruction” would cover situations in which a building or construction undergoes severe damage or a substantial physical change due to the removal of any item permanently installed in it, whereas “alteration” is a less drastic change. It commonly means a change in character or composition, typically of a comparatively small but significant nature.

¹²⁶⁰ The CJEU tends to adopt a rather extensive interpretation of the concept of “services connected with immovable property:” *see, inter alia*, Case C-37/

Services qualifying as services connected with immovable property include:

- (i) The drawing up of plans for a building or parts of a building with respect to immovable property whose location is identified by the moment at which the service is supplied;
- (ii) On-site supervision and security services (whether supplied through the physical presence of human resources on the site or supplied remotely (for example, by using technological means installed on site));
- (iii) The construction of buildings (the hiring of staff for purposes of construction works will only be considered connected with immovable property if the supplier of the staff assumes responsibility for the execution of the work);
- (iv) The construction of permanent structures (for example, pipeline systems);
- (v) Work on land and agricultural services (for example, land development works, garden landscaping provided with regard to a specific piece of land and services provided for purposes of preparing land for the cultivation of crops or of cultivating land (for example, through ploughing, harvesting, the clearing of land or the felling of trees));
- (vi) The surveying and assessment of risk and integrity implying the technical assessment of the physical state and/or integrity of a specific immovable property asset, its structural elements, equipment, seismic conditions, etc.;
- (vii) Valuation services;¹²⁶¹
- (viii) The leasing and letting of immovable property and services consisting of the storage of goods;¹²⁶²
- (ix) The provision of accommodation (not only accommodation in hotels but also accommodation “in sectors with a similar function, such as holiday camps or sites developed for the use of camping sites”) and timeshare usage rights;¹²⁶³

08, *RCI Europe* (timeshare exchange programs); Case C-270/09, *Macdonald Resorts Limited* (acquisition of timeshare usage rights).

¹²⁶¹ When the valuation of the immovable property assets is part of a complex due diligence service, this service can be considered connected with immovable property under VAT Implementing Regulation, Art. 31a(2)(g) if such valuation predominates.

¹²⁶² A specific part of the immovable property where the goods are stored must be assigned for the exclusive use of the customer (i.e., the space where the goods are stored must be identified, known by the customer and allocated exclusively to the customer’s needs for the whole duration of the contract) for the storage to be regarded as connected with immovable property. If the recipients of such storage service have no right of access to the part of the property where their goods are stored or the immovable property on which or in which those goods are stored does not constitute a central and essential element of the supply of services, the supply of complex storage services could fall outside the scope of VATD, Art. 47 (Case C-155/12, *RR Donelley Global Turnkey Solutions Poland*).

¹²⁶³ Timeshare usage rights are immovable property rights and their transfer in exchange for the enjoyment of similar rights constitutes a transaction connected with immovable property (Case C-37/08, *RCI Europe*). The service of facilitating, organizing or allowing the exchange of timeshare usage rights is consumed where the immovable property with respect to which the timeshare usage rights are exchanged is located. Therefore, the services provided by companies or associations administering and organizing the exchange between their

(x) The assignment or transfer of rights to use the whole or parts of an item of immovable property;¹²⁶⁴

(xi) The maintenance, renovation and repair of a building or parts of a building, including work such as cleaning, tiling, papering and parqueting;

(xii) The maintenance, renovation and repair of permanent structures;¹²⁶⁵

(xiii) The installation or assembly of machines or equipment;¹²⁶⁶

(xiv) The maintenance, repair, inspection and supervision of machines or equipment qualifying, on their installation or assembly, as immovable property;

(xv) Property management other than the portfolio management of investments in real estate,¹²⁶⁷ consisting of the operation of commercial, industrial or residential real estate by or on behalf of the owner of the property;

(xvi) Intermediation in the sale, leasing or letting of immovable property or in the establishment or transfer of certain interests in immovable property or rights *in rem* over immovable property (whether or not treated as tangible property), other than intermediation in the provision of hotel accommodation or accommodation in sectors with a similar function, such as holiday camps or sites developed

for use as camping sites, if the intermediary is acting in the name and on behalf of another person; and

(xvii) Legal services relating to the transfer of a title to immovable property, to the establishment or transfer of certain interests in immovable property or rights *in rem* over immovable property (whether or not treated as tangible property), such as notary work, or to the drawing up of a contract to sell or acquire immovable property, even if the underlying transaction resulting in the legal alteration of the property is not carried through.¹²⁶⁸

Advertising services,¹²⁶⁹ even if they involve the use of immovable property do not qualify as services connected with immovable property. Nor does the provision of a stand location at a fair or exhibition site together with other related services to enable the exhibitor to display items, such as the design of the stand, the transportation and storage of the items, the provision of machines, cable laying, insurance and advertising.¹²⁷⁰

(3) Supply of Transport

(a) Passenger Transportation

The place of supply of passenger transportation is the place where the transportation takes place, proportionate to the distances covered.¹²⁷¹

(b) Transport of goods

The place of supply in the case of the transport of goods, other than the intra-EU transport of goods, to a non-taxable person is the place where the transportation takes place, proportionate to the distances covered.¹²⁷²

The place of supply in the case of the intra-EU transport of goods to non-taxable persons is the place of departure.¹²⁷³ The “intra-EU transport of goods” refers to any transportation of goods where the place of departure and the place of arrival are situated within the territories of two different Member States.¹²⁷⁴ The “place of departure” refers to the place where the

members of their timeshare usage rights (both under traditional timeshare exchange schemes (Case C-37/08, *RCI Europe*) and under points-based timeshare ownership schemes (Case C-270/09, *Macdonald Resorts*)) are covered by the provision of “the right to stay in a specific place resulting from the conversion of timeshare usage rights.” According to the Explanatory Notes, it also follows from VAT Implementing Regulation, Art. 31a(3)(d) that intermediation in the provision of a right to stay in a specific place resulting from the conversion of timeshare usage rights, e.g., by facilitating the exchange of the usage rights, can be connected with immovable property, provided the intermediary is not acting in the name and on behalf of another person.

¹²⁶⁴ While examples such as mooring, anchorage, docking, the provision of berth services (Case C-428/02, *Fonden Marselisborg Lystbadehavn*) in port or airport premises, and the provision of rights to use specific port or airport areas would fall within the scope of VATD, Art. 47, additional services offered separately by the same suppliers (e.g.: cleaning or laundry services offered to customers on top of berth services; telecommunications, restaurant and catering services provided in airport VIP lounges; and the maintenance of boats moored in rented mooring places) do not fall within the scope of Art. 47, only because they are provided in ports or airports. However, if these same additional services are provided together as a package with a service connected with immovable property, it will be necessary to examine whether the package qualifies as a single supply for VAT purposes and is to be taxed accordingly. The Explanatory Notes indicate that office sharing may qualify if the use of the whole or parts of the immovable property (office space) constitutes the central and essential element of the contract. Regarding houseboats, see Case C-532/11, *Leichenich*.

¹²⁶⁵ VAT Implementing Regulation, Art. 31a(2)(l) provides a list of such structures (i.e., pipeline systems for gas, water and sewerage). However, this list is not exhaustive. According to the Explanatory Notes, other qualifying permanent structures would typically be facilities, infrastructures or installations needed for providing essential services and commodities such as transportation, electricity, heating, water supply and communications; the maintenance, renovation or repair of telecommunication infrastructures (e.g., the replacement of a cable network installed underground) can therefore constitute services covered by Art. 31a(2)(l).

¹²⁶⁶ See VAT Implementing Regulation, Art. 31a(2)(m) (positive cases) and Art. 31a(3)(f) (negative cases).

¹²⁶⁷ The portfolio management of investments in real estate is excluded from the scope of services considered to be connected with immovable property because this activity is a service of a financial nature and, as such, can be regarded as a financial transaction (Case C-44/11, *Deutsche Bank AG*).

¹²⁶⁸ Only legal services relating to one of the three points listed in VAT Implementing Regulation, Art. 31a(2)(q) are to be regarded as connected with immovable property. Consequently, legal services connected with the transfer of a title that happened at some point in the past (i.e., the service does not relate to a current or prospective transaction) cannot be treated as connected with immovable property. Examples of legal services not covered by Art. 31a(2)(q) would include: legal advice on contractual conditions or property-related litigation; tax advice on the capital allowance position with respect to a specific property; legal advice on real estate transfer taxes; and legal services connected with the provision of rights in pledges and mortgages or services linked to insolvency proceedings. Where legal services consist of drafting an agreement (such as a rental or leasing agreement) and the conclusion of the agreement would establish or transfer certain interests or rights *in rem* over immovable property, those services are to be regarded as covered by Art. 31a(2)(q). According to the Explanatory Notes, neither legal services relating to the financing of an immovable property purchase nor investment consultancy qualify as connected with immovable property as they are not aimed directly at the transfer of a title to immovable property, the establishment or transfer of certain interests in immovable property or rights *in rem* over immovable property (whether or not treated as tangible property).

¹²⁶⁹ VAT Implementing Regulation, Art. 31a(3)(c).

¹²⁷⁰ VAT Implementing Regulation, Art. 31a(3)(e).

¹²⁷¹ VATD, Art. 48. See, e.g., Case C-116/96, *Reisebüro Binder GmbH*.

¹²⁷² VATD, Art. 49.

¹²⁷³ VATD, Art. 50.

¹²⁷⁴ VATD, Art. 51.

transport of the goods actually begins, irrespective of the distances covered to reach the place where the goods are located. The “place of arrival” refers to the place where the transport of the goods actually ends.¹²⁷⁵

(4) *Supply of Cultural, Artistic, Sporting, Scientific, Educational, Entertainment and Similar Services, Ancillary Transport Services and Valuations of and Work on Movable Property*

The place of supply of services with respect to admission to cultural, artistic, sporting, scientific, educational, entertainment or similar events, such as fairs and exhibitions, and of ancillary services related to the admission, supplied to a taxable person, is the place where those events actually take place.¹²⁷⁶

The place of supply of services and ancillary services, relating to cultural, artistic, sporting, scientific, educational, entertainment or similar activities, such as fairs and exhibitions, including the supply of services of the organizers of such activities, supplied to a non-taxable person, is the place where those activities actually take place.¹²⁷⁷ Council Directive (EU) 2022/542 of April 5, 2022 amending Directives 2006/112/EC and (EU) 2020/285 as regards rates of value added tax adds the following subparagraph in Article 54(1) of the VATD, applicable as from January 1, 2025 to events that are streamed or otherwise made available virtually: “Where the services and ancillary services relate to activities which are streamed or otherwise made virtually available, the place of supply shall, however, be the place where the non-taxable person is established, has his permanent address or usually resides.”

The background of this addition is Case C-568/17, *Geelen*, where the CJEU had ruled that a complex service that consisted of offering interactive sessions of an erotic nature that are filmed and broadcast live on the Internet constitutes an “entertainment activity” and must be regarded as being “physically carried out” within the meaning of Article 54(1) of the VATD in the place where the service provider has established his place of business.¹²⁷⁸ The CJEU’s findings were the subject matter of Working Paper no. 1013 issued by the VAT Committee on April 19, 2021. Departing from the CJEU’s position, the Commission considered that “in the case of virtual activi-

ties/events, the place where such activities/events actually take place is where the customer is located and enjoys the entertainment,” i.e., the approach eventually codified by Council Directive (EU) 2022/542.

The place of supply of ancillary transportation activities such as loading, unloading, handling and similar activities and of valuations of, and work on, movable tangible property is the place where the services are physically carried out.¹²⁷⁹

(5) *Supply of Restaurant and Catering Services*

The place of supply of restaurant and catering services other than those physically carried out on board ships, aircraft or trains during the section of a passenger transportation operation effected within the European Union is the place where the services are physically carried out.¹²⁸⁰

(6) *Hiring of Means of Transport*

The place of short-term¹²⁸¹ hiring of a means of transport is the place where the means of transport is actually put at the disposal of the customer.¹²⁸²

The place of hiring, other than in the case of short-term hiring, of a means of transport to a non-taxable person is the place where the customer is established, has his or her permanent address or usually resides.¹²⁸³ However, the place of hiring a pleasure boat to a non-taxable person, other than in the case of short-term hiring, is the place where the pleasure boat is actually put at the disposal of the customer, where this service is actually provided by the supplier from its place of business or a fixed establishment situated at that place.¹²⁸⁴

(7) *Supply of Restaurant and Catering Services for Consumption on Board Ships, Aircraft or Trains*

The place of supply of restaurant and catering services that are physically provided on board ships, aircraft or trains during the section of a passenger transport operation effected within the European Union is the point of departure of the passenger transport operation.¹²⁸⁵

For this purpose, “section of a passenger transport operation effected within the European Union” refers to “the sec-

¹²⁷⁵ Member States need not apply VAT to that part of the intra-EU transportation of goods to non-taxable persons taking place over waters that do not form part of the territory of the European Union (VATD, Art. 52).

¹²⁷⁶ VATD, Art. 53; VAT Implementing Regulation, Arts. 32–33. See, e.g., Case C-647/17, *Srl Kosulterna*; Case C-532/22, *Westside Unicat*. Council Directive (EU) 2022/542 of April 5, 2022 amending Directives 2006/112/EC and (EU) 2020/285 as regards rates of value added tax adds a second paragraph in VATD, Art. 53 to the effect that the provision does not apply to admission to events where the attendance is virtual. The added paragraph is to apply from January 1, 2025 to events that are streamed or otherwise made available virtually.

¹²⁷⁷ VATD, Art. 54(1).

¹²⁷⁸ Advocate General Szpunar, in his Opinion of February 12, 2019 in the *Geelen* case, rightly observed that technological progress has led to the emergence of services that allow customers to participate, sometimes even actively, in a cultural, entertainment or other event, at a distance and not necessarily in real time. Thus, the “unity of action, time and place” to borrow a reference from classical theatre (i.e., the Aristotelian dramatic unities), has been disrupted, thus raising the question of how to embed such virtual events in the existing place-of-supply rules in a way that accords with the intention of the EU legislature, as that intention is to be interpreted in the context of the new technological developments and the objectives of those rules.

¹²⁷⁹ Respectively, VATD, Art. 54(2)(a); VAT Implementing Regulation, Art. 34 and VATD, Art. 54(2)(b); VAT Implementing Regulation, Art. 34.

¹²⁸⁰ VATD, Art. 55.

¹²⁸¹ “Short-term” means the continuous possession or use of the means of transport throughout a period of not more than 30 days and, in the case of vessels, not more than 90 days (VATD, Art. 56(3); see also VAT Implementing Regulation, Art. 39).

¹²⁸² VATD, Art. 56(1); VAT Implementing Regulation, Arts. 38–40. The term “means of transport” includes vehicles, whether motorized or not, and other equipment and devices designed to transport persons or objects from one place to another, which might be pulled, drawn or pushed by vehicles that are normally designed to be used and actually capable of being used for transport (VAT Implementing Regulation, Art. 38(1) (with an enumeration of particular means of transport in Art. 38(2) and the specification in Art. 38(3) that vehicles that are permanently immobilized and containers are not considered to be “means of transport”). The term “means of transport” has (also) been broadly construed by the CJEU, see, e.g., Case C-51/88, *Hamann v. Finanzamt Hamburg-Eimsbüttel* (concerning ocean-going sailing yachts used by their hirers for the practice of the sport of sailing): it covers anything that may be used to go from one place to another.

¹²⁸³ VATD, Art. 56(2), first para.

¹²⁸⁴ VATD, Art. 56(2), second para.

¹²⁸⁵ VATD, Art. 57(1); VAT Implementing Regulation, Arts. 35–37.

tion of the operation effected, without a stopover outside the European Union, between the point of departure and the point of arrival of the passenger transport operation.” “Point of departure of a passenger transport operation” refers to “the first scheduled point of passenger embarkation within the European Union, where applicable after a stopover outside the European Union.” “Point of arrival of a passenger transport operation” refers to “the last scheduled point of disembarkation within the European Union of passengers who embarked in the European Union, where applicable before a stopover outside the European Union.”¹²⁸⁶

In the case of a return trip, the return leg is regarded as a separate transport operation).¹²⁸⁷

(8) *The Supply of Telecommunications, Broadcasting and Electronic Services to Non-Taxable Persons*

Under Article 58 of the VATD, the place of supply of telecommunications services, radio and television broadcasting services and electronically supplied services (in particular those referred to in Annex II of the VATD) is the customer’s jurisdiction, wherever the supplier is based, be it an EU-based or a non-EU based business.¹²⁸⁸

The mere fact that the supplier of a service and the customer communicate via electronic mail does not of itself mean that the service supplied is an electronically supplied service.

In the case of a B2B transaction, the customer continues to be able to account for any tax due through the reverse charge, i.e., the business customer will account for the VAT in its jurisdiction. However, in the case of a B2C supply, it is not possible for the reverse charge to be applied. As a result, liability to account for any VAT due in a Member State rests entirely with the supplier.

The general place-of-supply rule for telecommunications, broadcasting and electronically (TBE) supplied services set out in Article 58 of the VATD (i.e. taxation in the Member State of the customer) does not apply, where the conditions of Article 59c(1) of the VATD¹²⁸⁹ are fulfilled, i.e.:

- (i) The supplier is established or, in the absence of an establishment, has a permanent address or usually resides only in one Member State;
- (ii) The services are supplied to non-taxable persons who are established, have their permanent address or usually reside in any Member State other than the Member State referred to in (i) or goods are dispatched or transported to a Member State other than the Member State referred to in (i); and
- (iii) The total value, exclusive of VAT, of the supplies referred to in (ii) neither exceeds a threshold of 10,000 euros or the equivalent in national currency (the corresponding value in national currency is to be calculated by applying the exchange rate published by the European Central Bank

on the date of adoption of Directive (EU) 2017/2455) in the current calendar year nor did so in the preceding calendar year.

In these circumstances, Article 59c(1) provides that supply of TBE services is subject to VAT in the Member State in which the supplier is established (meaning that supplies of cross-border TBE services up to 10,000 euros are subject to the same VAT treatment as domestic supplies). However, the supplier may decide not to use the 10,000-euro threshold and instead to apply the general place-of-supply rule of Article 58 (i.e., taxation in the Member State of the customer).¹²⁹⁰ In any event, as soon as the annual 10,000-euro threshold is exceeded during a calendar year, the general place-of-supply rule of Article 58 again becomes applicable as of that time.¹²⁹¹

(9) *Supply of Services (“Intangible Services”) to Non-Taxable Persons Outside the European Union*

The place of supply of the following services to a non-taxable person established, having a permanent address or usually residing outside the European Union is the place where the person is established, has the permanent address or usually resides:¹²⁹² (i) transfers and assignments of copyrights, patents, licenses, trademarks and similar rights;¹²⁹³ (ii) advertising services; (iii) the services of consultants, engineers, consultancy firms, lawyers, accountants and other similar services, as well as data processing and the provision of information;¹²⁹⁴ (iv) obligations to refrain from pursuing or exercising, in whole or in part, a business activity or a right referred to in Article 59 of the VATD; (v) banking, financial and insurance transactions including reinsurance but not including the hiring out of safes; (vi) the supply of staff; (vii) the hiring out of movable tangible property, with the exception of all means of transport; and (viii) the provision of access to a natural gas system situated within the territory of the European Union or to any network connected to such a system, to the electricity system or to heating or cooling networks, or the transmission or distribution through

¹²⁹⁰ VATD, Art. 59c(3).

¹²⁹¹ VATD, Art. 59c(2).

¹²⁹² VATD, Art. 59; VAT Implementing Regulation, Art. 41.

¹²⁹³ “Similar rights” include the greenhouse gas emission allowances defined in Directive 2003/87/EC of the European Parliament and of the Council of October 13, 2003 establishing a scheme for greenhouse gas emission allowance trading within the Community and amending Council Directive 96/61/EC, Art. 3(a) (Case C-453/15, *A and B*).

¹²⁹⁴ In Case C-267/21, *Uniqa Asigurări*, the CJEU held that VATD, Art. 59(1)(c) must be interpreted as meaning that claims settlement services provided by third-party companies, in the name and on behalf of an insurance company, do not fall within the scope of the “services of consultants, engineers, consultancy firms, lawyers, accountants and other similar services, as well as data processing and the provision of information” referred to in that provision. At issue were services rendered to an insurance company by third-party partner companies with their registered seats outside the Member State of the insurance company. The services consisted: as regards insurance against civil liability with respect to the use of motor vehicles, of handling the claims of the insurance company’s customers in the country in which the accident occurred (opening of complaints files, verification of the validity of the insurance policy, examination of the causes and circumstances of the accident, finding of damage, assessment of damage, proposal of replacement or repair solutions, estimation of compensation, and verification of quotes, as well as compensation for repairs and examination of recoveries); and, as regards medical insurance policies, of handling claims for compensation made by insurance policy holders (rendering assistance 24 hours a day and technical, organizational and legal assistance to insurance holders).

¹²⁸⁶ VATD, Art. 57(2).

¹²⁸⁷ VATD, Art. 57(2), *in fine*.

¹²⁸⁸ VATD, Art. 58(1).

¹²⁸⁹ Art. 59c was inserted in the VATD by Council Directive (EU) 2017/2455 of December 5, 2017 amending Directive 2006/112/EC and Directive 2009/132/EC as regards certain value added tax obligations for supplies of services and distance sales of goods.

these systems or networks, and the provision of other directly linked services.

c. “Effective-use-and-enjoyment” Option

To prevent double taxation, non-taxation and the distortion of competition, Member States may, with regard to services whose place of supply is governed by Articles 44, 45, 54(1) second subparagraph, 56, 58 and 59 of the VATD, consider the place of supply of any or all of those services: (i) if situated within their territory, to be situated outside the European Union if the effective use and enjoyment of the services takes place outside the European Union; and (ii) if situated outside the European Union, to be situated within their territory if the effective use and enjoyment of the services takes place within their territory.¹²⁹⁵

In other words, Member States are allowed to apply an effective-use-and-enjoyment standard in all transactions covered by the default B2B rule (Article 44 Art. 3(a) of the VATD), the default B2C rule (Article 45 of the VATD), the rule concerning cultural, etc. services (Article 54(1), second subparagraph of the VATD),¹²⁹⁶ the rule on the hiring of means of transport (Article 56 of the VATD), the rule on telecommunications, broadcasting and electronic services to non-taxable persons (Article 58 of the VATD), and the rule governing intangible services supplied to nontaxable persons (Article 59 of the VATD), with the effect that the place of supply shifts from the non-EU customer’s place of establishment to the Member State in which the services are effectively used and enjoyed, or from the taxable customer’s Member State of establishment to a place outside the European Union if the services are effectively used and enjoyed there. The CJEU seems to suggest that the intention “to prevent double taxation, nontaxation or distortion of competition” must be seen as the purpose of the “effective-use-and-enjoyment” rule rather than as a requirement for its application.¹²⁹⁷

Arguably, by inserting the “effective-use-and-enjoyment” option, the EU legislature has taken a step back in the evolution of the VAT harmonization process since, on the one hand, the option as such gives each Member State the power to overrule the place of supply of (specified) services and, on the other hand, Member States may have conflicting views on where services are effectively used and enjoyed, potentially leading to dis-harmonization and double taxation.

¹²⁹⁵ VATD, Art. 59a. See also, Case 593/19, *SK Telecom*: roaming services supplied by a mobile phone operator established in a third country to its customers who are also established, have their permanent address or usually reside in that third country, allowing them to use the national mobile telecommunications network of the Member State in which they are temporarily staying, must be considered to be “effectively used and enjoyed” within the territory of that Member State; that Member State may therefore consider the place of supply of those roaming services to be situated within its territory where, regardless of the tax treatment to which the services are subject under the domestic tax law of that third country, the exercise of such an option has the effect of preventing the non-taxation of the services within the European Union.

¹²⁹⁶ Added by Council Directive (EU) 2022/542 of April 5, 2022 amending Directives 2006/112/EC and (EU) 2020/285 as regards rates of value added tax (see the discussion of Article 54(1) at XVII.E.4.b.(3)(b), above).

¹²⁹⁷ Case C-1/08, *Athesia Druck*.

5. Place of Importation of Goods

The place of importation of goods is the Member State within whose territory the goods are located when they enter the European Union.¹²⁹⁸

By way of derogation, where, on entry into the European Union, goods that are not in free circulation are placed under one of the arrangements or situations referred to in Article 156 of the VATD (for example, free warehousing, customs warehousing or inward processing arrangements), under temporary importation arrangements with total exemption from import duty or under external transit arrangements, the place of importation of the goods is the Member State within whose territory the goods cease to be covered by those arrangements or situations.¹²⁹⁹ Similarly, where, on entry into the European Union, goods that are in free circulation are placed under one of the arrangements or situations referred to in Articles 276 and 277, the place of importation is the Member State within whose territory the goods cease to be covered by those arrangements or situations.¹³⁰⁰

F. Chargeable Event and Chargeability of Value Added Tax

1. General

The chargeable event with respect to a transaction is the occurrence by virtue of which the legal conditions necessary for VAT to become chargeable are fulfilled.¹³⁰¹ VAT becomes “chargeable” when the tax authority becomes entitled under the law, at a given moment, to claim the tax from the person liable to pay it, even though the time of payment may be deferred.¹³⁰² Hence, the term “chargeable event” refers to the basic tax point or when the transaction is effected, and the term chargeability refers to the actual tax point, i.e., when VAT is to be accounted for. The distinction between the chargeable event and chargeability, or the basic and the actual tax point, constitutes a matter of logical definition. For VAT to become chargeable, the basic tax point has to take place. In other words, it is a prerequisite for the actual tax point to occur. The chargeable event refers to a factual happening (for example, the transfer of the right to dispose of goods as owner), while chargeability refers to the legal consequences of the factual happening (i.e., VAT becoming chargeable).

The parallel between liability for VAT and the right to a deduction constitutes a core principle in the VAT system. If the right to deduct were to arise earlier than the payment, the tax authority would in fact have to pre-finance VAT and *vice versa*. According to the VATD, the moment at which VAT becomes chargeable is decisive with respect to both the liability to pay and the right to deduct. To maintain the parallel, it is fundamental that the respective relevant VATD provisions be interpreted in such a way as to mirror each other.

Since the rules on the chargeable event and the chargeability of VAT do not determine the point in time from which

¹²⁹⁸ VATD, Art. 60.

¹²⁹⁹ VATD, Art. 61, first para.

¹³⁰⁰ VATD, Art. 61, second para.

¹³⁰¹ VATD, Art. 62(1).

¹³⁰² VATD, Art. 62(2).

the limitation period for the recovery of VAT begins to run and there are no other provisions in the VATD concerning that question, Member States are authorized to apply their own procedural rules, provided these are not less favorable than those governing similar domestic actions nor arranged in such a way as to render it virtually impossible or excessively difficult to exercise rights conferred by EU law.¹³⁰³

2. Time of Taxable Transactions

a. Supply of Goods or Services

As regards the supply of goods or services, the general rule is that the chargeable event occurs and VAT becomes chargeable when the goods or the services are supplied.¹³⁰⁴ Hence, under the general rule, the actual tax point occurs at the same time as the basic tax point, i.e., when the goods or services are supplied to the purchaser.

Supplies of goods (other than those consisting in the hire of goods for a certain period or the sale of goods on deferred terms) or services that give rise to successive statements of account or successive payments are regarded as being completed on the expiry of the periods to which the statements of account or payments relate.¹³⁰⁵ Member States may provide that in certain cases the continuous supply of goods or services over a pe-

riod of time is to be regarded as being completed at least at intervals of one year.¹³⁰⁶

However, where payment is to be made on account before goods or services are supplied, VAT becomes chargeable on receipt of the payment and on the amount received.¹³⁰⁷ The object of this rule is to avoid tax fraud. It is a mechanism that enables the authorities to ensure that VAT paid to a supplier as part of an invoice is immediately accounted for. It is also related to the purchaser's right to deduct input VAT.

In *X-Beteiligungsgesellschaft mbH*,¹³⁰⁸ the CJEU made it clear that a service supplied on a single occasion remunerated by way of installment payments does not fall within the scope of Article 64(1) of the VATD. The case concerned mediation services that were performed in return for a service fee payable in tranches. The service provider argued that it was only liable to pay VAT on receiving the installment payments. According to the Court, the taxable amount for VAT purposes includes everything that a supplier obtains in return from a customer for performing a supply of goods and/or services, that amount being determined at the time when the taxable event occurs. As, in the case at hand, the intermediation service was provided on one single occasion, the service provider was directly liable for VAT on the full amount of the fee. The fact that the recipient paid in installments does not imply that the intermediation services were rendered on an ongoing basis. In contrast, Article 64 introduces a legal fiction for transactions involving payment through instalments to the effect that the chargeable event and the chargeability of VAT are linked to the expiry of the periods to which the payments relate, so as to enable the determination of the precise moment at which the tax obligation arises without the need for any factual assessment.

By way of derogation from the rules set out above, Member States may provide that VAT is to become chargeable with respect to certain transactions (other than supplies of services with respect to which VAT is payable by the customer, and intra-EU supplies or transfers of goods) or certain categories of taxable person at one of the following times: (i) no later than the time at which the invoice is issued; (ii) no later than the time at which payment is received;¹³⁰⁹ and (iii) where an invoice is not issued or is issued late, within a specified time no later than on the expiry of the time limit for the issuing of invoices imposed by Member States under the second paragraph of Article 222 of the VATD or, where no such time-limit has been imposed by the Member States, within a specified period from the date of the chargeable event.¹³¹⁰

As regards "deemed supplier" online platforms (see XVII.D.1.c., above), the chargeable event occurs and VAT becomes chargeable at the time when the payment has been accepted.¹³¹¹

¹³⁰³ Case C-85/97, *Société Financière d'Investissements SPRL (SFI) v. Belgian State*; see also the Order of the CJEU in Case C-483/08, *Régie communale autonome du stade Luc Varenne v. Belgian State*.

¹³⁰⁴ VATD, Art. 63.

¹³⁰⁵ VATD, Art. 64(1). See, however, Case C-277/05, *Société thermale d'Eugénie-les-Bains*. In that case, the CJEU held that a fee charged in the event of cancellation is not subject to VAT but qualifies as non-taxable compensation. This is seemingly in contradiction with the Court's position in joined cases C-250/14 and C-289/14, where it ruled that advance payments may be subject to VAT in the case of "no shows." In those cases, airlines had treated non-refundable flight ticket payments they received and legally retained after a passenger's "no-show" at the time of departure, or after the ticket expiration date, as indemnities outside the scope of VAT. The CJEU, however, held that tickets issued by an airline company are subject to VAT, even if the tickets are not used, in cases where the passengers are unable to obtain a refund (for non-refundable tickets or for exchangeable tickets that have expired). According to the Court, the sum retained by the airline companies is not intended to compensate for damages suffered following a passenger's no-show but constitutes remuneration for a service, even where the passenger did not actually use the transport. In exchange for the price paid when the ticket was purchased, the passenger obtains the right to benefit from the transport services. Regardless of whether the passenger actually exercises that right, the airline company fulfills the services by enabling the passenger to benefit from those services (Joined Cases C-250/14 and C-289/14, *Air France-KLM and Hop!-Brit Air SAS*). See also Case C-295/17, *Meo — Serviços de Comunicações e Multimédia*, in which the CJEU held an amount payable under a fixed-term service contract that was terminated on the customer's default to constitute consideration for taxable supplies of services and not compensation for the customer's breach. The fact that the objective of the default sum was to discourage customers from not observing the minimum commitment period and to make good the damage that the operator suffers in the event of failure to observe that period, the fact that the remuneration received by a commercial agent for the conclusion of contracts stipulating a minimum period of commitment was higher than that provided for under contracts that do not stipulate such a period, and the fact that the amount invoiced was classified under national law as a penalty were considered not to be decisive for purposes of classifying the amount predetermined in the services contract that the customer is liable to pay in the event of early termination. See also Case C-622/23, *RHTB*, where the CJEU concluded that there was a direct link between the termination fee and (non-)completed construction services and that, hence, the termination fee owed by the breaching party was subject to VAT.

¹³⁰⁶ VATD, Art. 64(2), third para.

¹³⁰⁷ VATD, Art. 65.

¹³⁰⁸ Case C-324/20, *X-Beteiligungsgesellschaft mbH*.

¹³⁰⁹ Case C-9/20, *Grundstücksgemeinschaft Kollaustra e 136*: VATD, Art. 66, first para., point (b) constitutes a derogation from the rule laid down in VATD, Art. 63, it must be interpreted strictly; see also, Case C-169/12, *TNT Express Worldwide (Poland)* (and the case-law cited there).

¹³¹⁰ VATD, Art. 66, first para.

¹³¹¹ VATD, Art. 66a.

As regards intra-EU supplies, VAT becomes chargeable on the issue of the invoice or on the expiry of the time limit referred to in the first paragraph of Article 222 of the VATD if no invoice has been issued by that time (i.e., no later than on the 15th day of the month following that in which the chargeable event occurs).¹³¹² To maintain the parallelism between the chargeability of intra-EU supplies and acquisitions, this rule is mirrored by Article 69, which regulates the chargeability of VAT with respect to intra-EU acquisitions of goods (see XVII.F.2.b., below).

b. Intra-European Union Acquisitions of Goods

In the case of the intra-EU acquisition of goods, the chargeable event occurs when the intra-EU acquisition of goods is made. An intra-EU acquisition of goods is regarded as being made when the supply of similar goods is regarded as being effected within the territory of the relevant Member State.¹³¹³ It follows that the chargeable event with respect to an intra-EU acquisition is not — as it is in the case of a “supply of goods” — defined by reference to the “transfer of the right to dispose” criterion, but instead by reference to the governing law of the Member State in which the acquisition takes place for VAT purposes, hence the place of acquisition. In light of this, the transfer of the “right to dispose as owner” — and thus the imposition of VAT — may occur at different junctures depending on which Member State’s law is decisive. For instance, while the laws of France, Italy and Belgium consider property transferred by contract, under the law of the Netherlands, property is transferred by the formal act of delivery.

As regards the chargeability of VAT or the actual tax point with respect to the intra-EU acquisition of goods, VAT becomes chargeable on the issue of an invoice, or on the expiry of the time limit referred to in the first paragraph of Article 222 of the VATD if no invoice has been issued by that time. As indicated, this rule mirrors Article 69, which governs the chargeability of VAT with respect to intra-EU supplies of goods and, hence, the same analysis applies *mutatis mutandis* (see XVII.F.2.a., above).

c. Importation of Goods

The main rule in the case of the importation of goods is that the chargeable event occurs, and VAT becomes chargeable, when the goods are imported.¹³¹⁴

By way of derogation, where, on entry into the European Union, goods are placed under one of the arrangements or situations referred to in Articles 156, 276 and 277 of the VATD (including temporary storage, customs warehousing arrangements and free zoning), under temporary importation arrangements with total exemption from import duty, or under external transit arrangements, the chargeable event occurs and VAT becomes chargeable only when the goods cease to be covered by those arrangements or situations. However, where imported goods are subject to customs duties, to agricultural levies or to charges having equivalent effect established under a common

policy, the chargeable event occurs and VAT becomes chargeable when the chargeable event with respect to those duties occurs and the duties become chargeable.¹³¹⁵

Where imported goods are not subject to any such duties, Member States are, as regards the chargeable event and the moment when VAT becomes chargeable, to apply the provisions in force governing customs duties.¹³¹⁶

The rules on the chargeable event and the chargeability of VAT are thus connected with the equivalent rules for customs duties purposes. The main VAT chargeable event/chargeability rule serves as a general background provision stipulating that the importation of goods gives rise to the VAT liability — but that the details as to when, where and by what exact action or failure to act the VAT liability is triggered are determined by the customs rules. The main VAT chargeable event/chargeability rule has, however, full significance in determining the chargeable event for VAT on goods that are imported from third territories forming part of the EU customs territory.

G. Taxable Amount

1. Supplies of Goods and Services

a. General Rule

In the case of a supply of goods or services, the general rule is that the taxable amount includes everything that constitutes consideration obtained or to be obtained by the supplier, in return for the supply, from the customer or a third party, including subsidies directly linked to the price of the supply.¹³¹⁷ In other words, the taxable amount for the supply of goods or services for consideration is the consideration actually received for the supply by the taxable person. That consideration is thus the subjective value, that is to say, the value actually received, and not a value estimated according to objective criteria.¹³¹⁸ The corollary of this principle is that the tax authorities may not collect as VAT an amount exceeding the tax paid to the taxable person.¹³¹⁹ It follows that, when a contract of sale has been concluded without reference to VAT, in a situation where the supplier has no means under national law of recovering from the purchaser the VAT claimed subsequently by the tax authorities,

¹³¹⁵ VATD, Art. 71(1).

¹³¹⁶ VATD, Art. 71(2).

¹³¹⁷ VATD, Art. 73. See, e.g., Case C-256/14, *Lisboagás GDL*: the amount of tax that is paid to municipalities by the company holding the gas distribution concession in return for the use of publicly-owned property belonging to those municipalities and that is then passed on by that company to another company responsible for marketing the gas, then by that company on to the final consumers, must be included in the taxable amount for VAT applicable to the supply of services provided by the first company to the second company.

¹³¹⁸ Case 154/80 *Coöperatieve Aardappelenbewaarplaats*; Case C-412/03, *Hotel Scandic Gässabäck*; Case C-285/10, *Campsa Estaciones de Servicio*; see also, as regards barter supplies: Case C-549/11, *Orfey Bulgaria* and Case C-19/12, *Efir*: the barter taxable base should be the value of the supply received, i.e., the value that corresponds to the amount that the recipient is prepared to spend to obtain the respective supply (i.e., the subjective value). See, however, Case C-576/15, *Marinova*: with respect to goods missing from a warehouse, where the tax documents of relevance to those goods have not been recorded in the accounts of the taxable person concerned, the tax authorities may presume that the taxable person subsequently sold those goods to third parties and determine the taxable amount of the sale of those goods according to the factual information at hand in accordance with rules not provided for in the VATD.

¹³¹⁹ Case C-330/95, *Goldsmiths*.

¹³¹² VATD, Art. 67, as rearticulated by Directive 2010/45/EU amending the VATD as regards the rules of invoicing (Member States had to implement this by January 1, 2013).

¹³¹³ VATD, Art. 68.

¹³¹⁴ VATD, Art. 70.

taking the total price, without deducting the VAT, as the taxable amount on which the VAT is to be levied would lead to a situation in which it is the supplier that bears the VAT burden. Hence, in such a situation, the price agreed must be regarded as already including the VAT (the situation is different when the supplier has the ability under national law to add to the agreed price a supplement equal to the tax applicable to the transaction and recover it from the purchaser of the goods or the recipient of the services).¹³²⁰

The taxable amount includes: (i) taxes, duties, levies and charges, excluding the VAT itself; and (ii) incidental expenses, such as commission, packing, transport and insurance costs, charged by the supplier to the customer (Member States may regard expenses covered by a separate agreement as incidental expenses).¹³²¹ For taxes, duties, levies and charges to be included in the taxable amount for VAT purposes, even though they do not represent any added value and do not constitute the financial consideration for the supply, they must have a direct link with that supply.¹³²² A decisive factor for purposes of establishing the existence of such a link is whether the chargeable event for purposes of the tax at issue coincides with that for VAT purposes.¹³²³

As noted above, the taxable amount also includes “subsidies directly linked to the price of the supply.” According to the CJEU, a subsidy is a payment in cash or in kind made (by the State) in support of an undertaking, other than the payment by the purchaser or consumer for the goods or services supplied.¹³²⁴ However, only subsidies that may be regarded as “consideration” are to be included in the taxable amount. This will be the case if the subsidy is paid to the supplier directly by the purchaser (direct consideration) or by a third party,¹³²⁵ or if the purchaser is granted a subsidy to enable it to receive a particular supply. If a subsidy cannot be considered consideration (a “genuine” subsidy), it cannot lead to a taxable event and, hence, has no VAT implications.

The taxable amount does not include: (i) price reductions by way of discount for early payment; (ii) price discounts and rebates granted to the customer at the time of the supply; and (iii) amounts received by a taxable person from the customer, as repayment of expenditure incurred in the name and on behalf of the customer, and entered in its books in a suspense account.¹³²⁶

In this regard, in *Naturally Yours Cosmetics*,¹³²⁷ the CJEU equated payments in kind with payments in money. Naturally

Yours supplied goods as an inducement to “retailers” for a monetary consideration that was less than the normal wholesale price. However, the retailer had to apply the inducement to procure or reward other persons for arranging a gathering at which further goods of Naturally Yours could be sold by the retailer to the public for the mutual benefit of Naturally Yours and the retailer. If the retailer failed to apply the inducement in this way, the retailer had to pay the normal wholesale price for the inducement goods. The taxable amount of the inducement goods sold by Naturally Yours “at a discount” was the sum of the monetary consideration and the value of the service provided by the retailer, which consisted in having the gathering arranged. The value of that service had to be regarded as being equal to the difference between the price actually paid for the product and its normal wholesale price.

In *Argos* and *Elida Gibbs*, the CJEU interpreted the notion of “taxable amount” with respect to vouchers.¹³²⁸ In both cases, the taxpayers had awarded special discount offers to customers. The Court was asked whether VAT should be levied on the full value of the goods concerned or only on the face value of the discounted offers. The Court decided in favor of the latter.¹³²⁹ Because VAT is intended to be a tax on the final customer only, it is clear that the taxable amount on which VAT is due can in no event exceed the consideration actually paid by the final customer. Thus, the Court held in *Argos* that a supplier that has sold vouchers at a discount and accepts those vouchers at face value on a purchase of goods, should only pay VAT on the sum actually received on the sale of the voucher. These cases are, in fact, a follow-up to a previous, seminal decision relating to VAT due in the context of price discounts and rebates that held the same way.¹³³⁰ In *Lebara*,¹³³¹ which concerned face-value phone card vouchers sold by the issuer through distributors in other EU Member States rather than directly to end users, the CJEU held that the taxable amount of the provision of this service should be strictly proportional to the price paid by the customer, meaning that the nominal or face value of the phone card could not serve as the taxable amount for VAT purposes. Council Directive (EU) 2016/1065 of June 27, 2016, amending Directive 2006/112/EC as regards the treatment of vouchers¹³³² inserted a new Article 73a in the VATD to the effect that the taxable amount of the supply of goods or services provided with respect to a multi-purpose voucher is equal to the consideration paid for the voucher or, in the absence of information on that consideration, the monetary value indicated on the multi-purpose voucher itself or in the related documentation, less the amount of VAT relating to the goods or services supplied. These rules would not apply to instruments entitling the holder to a discount on the purchase of goods or services but carrying no right to receive such goods or services, nor should they affect the VAT treatment of transport tickets, cinema and museum admission tickets, postage stamps or the like. Also, the of-

¹³²⁰ Joined Cases C-249/12, *Corina-Hrisi Tulică v. Agenia Națională de Administrare Fiscală — Direcția Generală de Soluționare a Contestațiilor* and C-250/12, *Călin Ion Plavoin v. Direcția Generală a Finanelor Publice Timi — Serviciul Soluționare Contestații, Activitatea de Inspectie Fiscală — Serviciul de Inspectie Fiscală Timi*.

¹³²¹ VATD, Art. 78.

¹³²² Case C-228/09, *Commission v. Poland*; Case C-106/10, *Lidl & Company*.

¹³²³ Case C-98/05, *De Danske Bilimportører*; Case C-228/09, *Commission v. Poland*; Joined Cases C-618/11, C-637/11 and C-659/11, *TVI-Televisão Independente SA v. Fazenda Pública* (screening tax on commercial advertising in cinemas and on television).

¹³²⁴ Case 30/59, *De Gezamenlijke Steenkoolmijnen*.

¹³²⁵ Case 184/00, *Office des produits wallons* (there must be a direct economic connection between the granting of the subsidy and the supply).

¹³²⁶ VATD, Art. 79.

¹³²⁷ Case 230/87, *Naturally Yours Cosmetics*.

¹³²⁸ Case 288/94, *Argos*; Case 317/94, *Elida Gibbs*.

¹³²⁹ In Case C-300/12, *Ibero Tours*, the CJEU expressly stated that the principles established in *Elida Gibbs* do not apply when a travel agent, acting as an intermediary, grants to the final consumer, on the travel agent’s own initiative and at its own expense, a price reduction on the principal service provided by the tour operator.

¹³³⁰ Case 126/88, *Boots*.

¹³³¹ Case C-520/10, *Lebara*.

¹³³² See the discussion at XVII.D.1.e. and XVII.D.3.c.

fering of retail vouchers to employees, in the context of a program designed to recognize and reward high-performing employees, does not constitute a supply of services for consideration and thus is not subject to VAT.¹³³³ Loyalty points do not qualify as vouchers.¹³³⁴

Separate provisions deal with the private use of goods and services belonging to an enterprise. The taxable amount in the case of the application of business assets for private use is the purchase price of the goods or of similar goods or, in the absence of a purchase price, the cost price, determined at the time when the application, disposal or retention takes place.¹³³⁵ The taxable amount in the case of private use with respect to services is the open market value of the services supplied,¹³³⁶ unless the services are carried out free of charge, in which case the taxable amount is the full cost to the taxable person of providing the services.¹³³⁷

As regards intra-EU supplies of goods, the taxable amount is the purchase price of the goods or similar goods or, in the absence of a purchase price, the cost price, determined at the time the transfer takes place.¹³³⁸

b. Derogatory Rule: “Open Market Value”

To prevent tax evasion or avoidance, Member States may, in certain cases (i.e., where the consideration for a supply is lower or higher than its open market value and the recipient of the supply does not have a full right of deduction under specified provisions of the VATD), take measures to ensure that, with respect to the supply of goods or services involving family or other close personal ties, management, ownership, membership, or financial or legal ties as defined by the Member State concerned, the taxable amount is the open market value. Legal ties may include the relationship between an employer and an employee or an employee’s family, or any other closely connected persons.¹³³⁹

The “open market value” is the full amount that a customer, at the same marketing stage at which the supply of goods or services takes place, would have to pay, under conditions of fair competition, to a supplier at arm’s length within the territory of the Member State in which the supply is subject to tax, to obtain the goods or services in question at that time. Where no comparable supply of goods or services can be ascertained, “open market value” means: (i) with respect to goods, an amount that is not less than the purchase price of the goods or of similar goods or, in the absence of a purchase price, the cost price, determined at the time of supply; and (ii) with respect to services, an amount that is not less than the full cost to the taxable person of providing the services.¹³⁴⁰

¹³³³ See Case C-607/20, *GE Aircraft Engine Services*.

¹³³⁴ Case C-436/24, *Lyko*. The judgment leaves uncertainty about the VAT treatment of the bonus goods themselves (free supply or part of the paid transaction) — further clarification may follow in Case T-914/25, *Modelo Continente Hipermercados*, currently pending before the General Court.

¹³³⁵ VATD, Art. 74.

¹³³⁶ VATD, Art. 77; for the concept of “open market value,” see XVII.G.1.b.

¹³³⁷ VATD, Art. 75.

¹³³⁸ VATD, Art. 76.

¹³³⁹ VATD, Art. 80(1).

¹³⁴⁰ VATD, Art. 72.

In allowing the taxable amount to be taken as the open market value of the transaction in certain specified cases, the VATD lays down an exception to the general rule stated in Article 73 (see XVII.G.1.a., above), which must as such be interpreted strictly.¹³⁴¹ In addition, the open market value may only be used as the taxable amount in the case of supplies involving family or other close personal, management, ownership, membership or legal ties and, therefore, Member States are not permitted to apply the open market value as the basis of assessment in the case of transactions not effected between parties having such ties.¹³⁴²

2. Intra-European Union Acquisition of Goods

In the case of the intra-EU acquisition of goods, the taxable amount is established based on the same factors as are used to determine the taxable amount for the supply of the same goods within the territory of the Member State concerned.¹³⁴³

The excise duty due from or paid by the person making the intra-EU acquisition of a product subject to excise duty is included in the taxable amount. However, where, after the intra-EU acquisition of goods has taken place, the person acquiring the goods obtains a refund of the excise duty paid in the Member State in which the dispatch or transportation of the goods began, the taxable amount is reduced accordingly in the Member State in whose territory the acquisition took place.¹³⁴⁴

3. Importation of Goods

Special rules apply in the case of the importation of goods, where the taxable amount is the value for customs purposes, determined in accordance with the EU provisions in force.¹³⁴⁵ To the extent such items are not already included, the taxable amount includes: (i) taxes, duties, levies and other charges due outside the Member State of importation, and those due by reason of importation, excluding the VAT to be levied; and (ii) incidental expenses, such as commission, packing, transport and insurance costs, incurred up to the first place of destination within the territory of the Member State of importation (i.e., the place indicated on the consignment note or any other document under which the goods are imported into the Member State of importation or, if there is no such indication, the place of the first transfer of cargo in the Member State of importation), as well as costs arising from transportation to another destination within the European Union, if that other destination is known when the chargeable event occurs.¹³⁴⁶ The taxable amount does not include: (i) price reductions by way of discount for early payment; or (ii) price discounts and rebates granted to a customer and obtained by the customer at the time of importation.¹³⁴⁷

Where goods temporarily exported from the European Union are re-imported after having undergone repair, process-

¹³⁴¹ Case C-453/05 *Ludwig*; Case C-41/09, *Commission v. Netherlands*; Joined Cases C-621/10, *Balkan and Sea Properties ADSITs* and C-129/11, *Provadinvest OOD*.

¹³⁴² Case C-549/11, *Ofrey Bulgaria*.

¹³⁴³ VATD, Art. 83.

¹³⁴⁴ VATD, Art. 84.

¹³⁴⁵ VATD, Art. 85.

¹³⁴⁶ VATD, Art. 86.

¹³⁴⁷ VATD, Art. 87.

ing, adaptation, making up or re-working, a Member State is to take steps to ensure that the tax treatment of the goods for VAT purposes is the same as that which would have applied had the repair, processing, adaptation, making up or re-working been carried out within its territory.¹³⁴⁸

4. Miscellaneous Provisions

In the case of cancellation, refusal or total or partial non-payment, or where the price is reduced after a supply is made, the taxable amount of the supply is reduced accordingly subject to conditions to be determined by the Member States. In the case of total or partial nonpayment, Member States may derogate from this rule.¹³⁴⁹

In *Boehringer Ingelheim*,¹³⁵⁰ the question was raised whether *Boehringer Ingelheim* had the right to deduct from its VAT tax base certain contributions it had made to the Hungarian State Health Insurance Agency (*Nemzeti Egészségbiztosítási Alapkezelő*, NEAK) to ensure that its medicines would be subsidized within Hungary by NEAK. In its ruling of October 6, 2021, the CJEU held that payments under the relevant “financing contract” — a type of reimbursement agreement, rather than a statutory provision — could in fact reduce *Boehringer Ingelheim*’s tax base for VAT purposes. The Court reasoned that the provisions of Hungarian domestic law implementing Article 90 of the VATD in effect deprived all pharmaceutical companies in *Boehringer Ingelheim*’s situation of the ability to reduce their tax base for VAT purposes retrospectively based on similar contributions, even where such contributions in fact resulted in a price reduction within the meaning of Article 90(1) of the VATD.

In *Novo Nordisk A/S*,¹³⁵¹ the CJEU examined whether payments made by pharmaceutical companies to Hungary’s State health insurance body were to be treated as a tax or a rebate from a VAT perspective. The case is different from the earlier German and Hungarian *Boehringer* cases in that the payments at hand were mandated by law rather than by contractual agreements. Although the applicable law referred to these payments as “mandatory,” it did not classify them as taxes. In addition, the legislative history suggested the Hungarian legislature’s intention was to introduce a mandatory rebate, not a tax. Reasoning that because of due to these mandatory rebates pharmaceutical companies do not receive full payment for their products and the public insurer uses these contributions to lower medicine prices for consumers, the CJEU held the payments to qualify as rebates and thus eligible to be deducted from the VAT base and, hence, for VAT refund rights.

¹³⁴⁸ VATD, Art. 88.

¹³⁴⁹ VATD, Art. 90. See, e.g., Case C-482/21, *Euler Hermes*, in which the CJEU held that the exercise of the power to derogate cannot allow Member States to exclude altogether a reduction of the taxable amount of VAT in the event of non-payment. According to the Court, that power is only intended to enable the Member States to counteract uncertainty as to the non-payment of an invoice or the definitive nature of that non-payment, and does not resolve the issue of whether a reduction of the taxable amount might not be granted in the case of non-payment; see also Case C-507/20, *FGSZ*.

¹³⁵⁰ Case C-717/19, *Boehringer Ingelheim*; in the same vein, see Case C-462/16 *Finanzamt Bingen-Alzey v. Boehringer Ingelheim Pharma GmbH & Co KG*.

¹³⁵¹ Case C-248/23, *Novo Nordisk A/S*.

Special exchange rate rules apply where the factors used to determine the taxable amount on importation are expressed in a currency other than that of the Member State in which assessment takes place.¹³⁵²

As regards the costs of returnable packing material, Member States may either: (i) exclude such costs from the taxable amount and take the measures necessary to ensure this amount is adjusted if the packing material is not returned; or (ii) include such costs in the taxable amount and take the measures necessary to ensure this amount is adjusted if the packing material is in fact returned.¹³⁵³

H. Tax Rates

1. Introduction

The harmonization or approximation of VAT rates is an area in which arguably less progress has been achieved to date. Initially, the Sixth Directive focused on the VAT base rather than VAT rates — Article 28(2) of the Sixth Directive allowed Member States to maintain reduced rates and exemptions in force on December 31, 1975 that satisfied the criteria stated in the last indent of Article 17 of the Second Directive (referring to exemptions maintained for clearly defined social reasons and the benefit of the final consumer). Agreement on (some form of) harmonization of the VAT rates was reached in June 1991, as encompassed by Directive 92/77/EEC of October 19, 1992. These provisions are now incorporated in Article 98 and Annex III to the VATD.

In summary, all Member States must apply a standard VAT rate of 15% or more and have the option of applying one or two reduced rates, no lower than 5%, to a list of certain specified goods (this list is now consolidated in Annex III to the VATD). States may continue to charge any lower rates (including zero rates) that were in place on January 1, 1991, though they may not introduce any new rate below 5%.

In principle, the rate applicable to taxable transactions is that in force at the time of the chargeable event.¹³⁵⁴ However, in the case of an intra-EU acquisition of goods, the rate applicable is that in force when VAT becomes chargeable as applied to the supply of like goods within the territory of the Member State concerned.¹³⁵⁵

2. Structure and Level of Rates

a. Standard Rate

The standard rate is fixed by each Member State as a percentage of the taxable amount and is to be the same for the supply of goods and the supply of services.¹³⁵⁶ The standard rate may not be lower than 15%.¹³⁵⁷

¹³⁵² VATD, Art. 91.

¹³⁵³ VATD, Art. 92.

¹³⁵⁴ VATD, Art. 93, first para.

¹³⁵⁵ VATD, Art. 93, second para, (b) and Art. 94(1).

¹³⁵⁶ VATD, Art. 96.

¹³⁵⁷ VATD, Art. 97.

b. Reduced Rates

(1) Minimum 5% Reduced Rate

Member States may apply a maximum of two reduced rates, expressed as a percentage of the taxable amount, which may not be less than 5%, but only to supplies of goods or services in the categories set out in Annex III to the VATD.¹³⁵⁸ Member States may apply the reduced rates to supplies of goods or services covered in a maximum of 24 points in Annex III.

Annex III lists the following:¹³⁵⁹ (1) foodstuffs (including beverages but excluding alcoholic beverages) for human and animal consumption; and live animals, seeds, plants and ingredients normally intended for use in the preparation of foodstuffs; and products normally used to supplement foodstuffs or as a substitute for foodstuffs; (2) the supply of water;¹³⁶⁰ (3) pharmaceutical products used for medical and veterinary purposes, including products used for contraception and female sanitary protection, and absorbent hygiene products;¹³⁶¹ (4) medical equipment, appliances, devices, items, aids and protective gear, including health protection masks, normally intended for use in healthcare or for the use of the disabled, and goods essential to compensating for and overcoming disability, as well as the adaptation, repair, rental and leasing of such goods;¹³⁶² (5) the transportation of passengers and the transportation of goods accompanying passengers, such as luggage,

bicycles, including electric bicycles, motor or other vehicles, or the supply of services relating to the transportation of passengers; (6) the supply, including the supply on loan by libraries, of books, newspapers and periodicals,¹³⁶³ supplied either on physical means of support or electronically, or both (including brochures; leaflets and similar printed matter; children's picture, drawing or coloring books; music printed or in manuscript form; and maps and hydrographic or similar charts), other than material wholly or predominantly devoted to advertising¹³⁶⁴ and other than publications wholly or predominantly consisting of video content or audible music; the production of publications of non-profit-making organizations and services related to such production;¹³⁶⁵ (7) admission to shows, theatres, circuses, fairs, amusement parks, concerts, museums, zoos, cinemas, exhibitions, and similar cultural events and facilities or access to the live-screening of those events or visits or both;¹³⁶⁶ (8) the reception of radio and television broadcasting services and the web-casting of such programs provided by a media service provider; and internet access services provided as part of digitalization policy, as defined by the Member States; (9) the supply of services by writers, composers and performing artists, or the royalties due to them; (10) the supply and construction of housing,

¹³⁵⁸ VATD, Art. 98(1); see Case C-83/99, *Commission v. Spain* (application of Spanish reduced VAT rate to the supply of services consisting in making road infrastructure available to users on payment of a toll: not permitted); Case C-49/09, *Commission v. Poland* (application of Polish reduced 7% rate to the supply, importation and intra-EU acquisition of clothing and clothing accessories for babies and of children's footwear: not permitted); Case C-639/13, *Commission v. Poland* (goods for fire protection). See also Joined Cases C-409/24 to C-411/24 *J-GmbH v. Finanzamt K* (C-409/24), *D v. Finanzamt F* (C-410/24) and *D GmbH & Co. KG v. Finanzamt A* (C-411/24): Member States may apply a reduced VAT rate selectively to specific aspects of short-term accommodation services under Article 98 of the VATD and Annex III, point 12; accordingly, national legislation may exclude ancillary services such as breakfast, parking or wellness facilities from the reduced rate where those services do not directly serve the accommodation itself, provided that the principle of fiscal neutrality is respected.

¹³⁵⁹ By December 31, 2028 and every five years thereafter, the Commission is to submit to the Council a report on the scope of Annex III, accompanied by any appropriate proposals, where necessary (VATD, Art. 100).

¹³⁶⁰ Case C-442/05, *Finanzamt Oschatz v. Zweckverband zur Trinkwasserversorgung und Abwasserbeseitigung Torgau-Westelbien* (the laying of a mains connection that consists in the installation of piping permitting the connection of a building's water system to the fixed water supply network forms part of the "supply of water" or "water supplies," with respect to which Member States may apply a reduced VAT rate, provided they comply with the principle of fiscal neutrality inherent in the common system of VAT).

¹³⁶¹ Case C-360/11, *Commission v. Spain*: the application of a reduced rate of VAT only relates to finished goods that may be used directly by final consumers and, hence, does not extend to goods (such as medicinal substances) that may be used in the production of medicinal products and that normally require further processing.

¹³⁶² Case C-360/11, *Commission v. Spain*: medical devices, material, equipment and appliances used only to prevent, diagnose, treat, alleviate or cure human or animal illnesses or ailments are not covered by this category. See also Case C-573/15, *Oxycure Belgium*: VATD, Art. 98(1) and (2) and Annex III, points (3) and (4), read in light of the principle of fiscal neutrality, do not preclude national legislation that provides for the application of the standard rate of VAT to the supply or rental of oxygen concentrators, while that legislation provides for the application of the reduced VAT rate to the supply of oxygen cylinders.

¹³⁶³ Member States may use the CN to define these categories. CN Code 4902 covers "Newspapers, journals and periodicals, whether or not illustrated or containing advertising material." In Case C-375/24, *Keesing Deutschland GmbH v. Finanzamt für Körperschaften II*, the CJEU held that periodically issued numerical Sudoku books with minimal text are to be considered periodicals within the meaning of CN Code 4902, thereby allowing the application of the reduced VAT rate in Member States that use classification under heading 4902 as a criterion.

¹³⁶⁴ Case C-219/13, *K Oy*: provided the principle of fiscal neutrality inherent in the common system of VAT is observed, VATD, Art. 98(2), first subpara. and Annex III, point (6) do not preclude national legislation under which books published in paper form are subject to a reduced rate of VAT and books published on other physical supports such as CDs, CD-ROMs or USB keys are subject to the standard rate; see, however, Case C-390/15, *RPO* (supply of digital books electronically), in which the CJEU held that the supply of digital publications on physical means of support and the supply of digital publications electronically amount to comparable situations. This decision led to the adoption of Council Directive (EU) 2018/1713 of November 6, 2018 amending the VATD as regards rates of VAT applied to books, newspapers and periodicals. The Directive also replaced Annex III, point (6) with the following text: "(6) [the] supply, including on loan by libraries, of books, newspapers and periodicals either on physical means of support or supplied electronically or both (including brochures, leaflets and similar printed matter, children's picture, drawing or coloring books, music printed or in manuscript form, maps and hydrographic or similar charts), other than publications wholly or predominantly devoted to advertising and other than publications wholly or predominantly consisting of video content or audible music."

¹³⁶⁵ The insertion of electronically supplied books, newspapers and periodicals builds on the CJEU's decision in Case C-390/15, *RPO* following which the supply of digital publications on physical means of support and the supply of digital publications electronically amount to comparable situations. According to the Court, it is therefore appropriate to allow all Member States to apply a reduced VAT rate to the supply of books, newspapers and periodicals, irrespective of whether they are supplied on physical means of support or electronically. For the same reasons, it is appropriate to allow those Member States that, in accordance with EU law, apply VAT rates lower than the minimum laid down in VATD, Art. 98 or that grant exemptions, with deductibility of the VAT paid at the preceding stage, with respect to certain books, newspapers or periodicals supplied on physical means of support, to apply the same VAT treatment to such books, newspapers or periodicals when supplied electronically.

¹³⁶⁶ Case C-109/02, *Commission v. Germany* (applying a reduced VAT rate to services provided directly to the public by musical ensembles or for a concert organizer and to services provided directly to the public by soloists, while applying the standard VAT rate to the services of soloists working for an organizer: not permitted).

as part of a social policy, as defined by the Member States; the renovation and alteration, including demolition and reconstruction, and the repair of housing and private dwellings; the letting of immovable property for residential use; (10a) the construction and renovation of public and other buildings used for activities in the public interest; (10b) window-cleaning and cleaning in private households; (10c) the supply and installation of solar panels on or adjacent to private dwellings, housing and public and other buildings used for activities in the public interest; (11) the supply of goods and services of a kind normally intended for use in agricultural production but excluding capital goods such as machinery and buildings; and, until January 1, 2032, the supply of chemical pesticides and chemical fertilizers;¹³⁶⁷ (11a) live equines and the supply of services related to live equines; (12) accommodation provided in hotels and similar establishments, including the provision of holiday accommodation and the letting of places on camping or caravan sites; (12a) restaurant and catering services — the supply of (alcoholic and/or nonalcoholic) beverages may be excluded;¹³⁶⁸ (13) admission to sporting events or access to the live-streaming of such events or both; the use of sporting facilities,¹³⁶⁹ and the supply of sport or physical exercise classes, including when live-streamed; (14) [deleted]; (15) the supply of goods and services by organizations engaged in welfare or social security work as defined by the Member States and recognized as being devoted to social wellbeing by the Member States, insofar as such transactions are not exempt under Articles 132, 135 and 136 of the VATD;¹³⁷⁰ (16) the supply of ser-

vices by undertakers and cremation services, and the supply of related goods;¹³⁷¹ (17) the provision of medical and dental care and thermal treatment insofar as such services are not exempt under points (b) to (e) of Article 132(1) of the VATD; (18) the supply of services in connection with sewage, street cleaning, refuse collection and waste treatment or waste recycling, other than the supply of such services by bodies referred to in Article 13 of the VATD; (19) the supply of repair services with respect to household appliances, shoes and leather goods, clothing and household linen (including mending and alteration); (20) domestic care services such as home help and the care of the young, the elderly, the sick or the disabled; (21) hairdressing; (22) the supply of electricity, district heating and district cooling, and biogas produced by the feedstock listed in Annex IX, Part A to Directive (EU) 2018/2001 of the European Parliament and of the Council; the supply and installation of highly efficient low-emission heating systems meeting the emission (PM) benchmarks laid down in Annex V to Commission Regulation (EU) 2015/1189 and in Annex V to Commission Regulation (EU) 2015/1185 that have been granted an EU energy label to show that the criterion referred to in Article 7(2) of Regulation (EU) 2017/1369 of the European Parliament and of the Council is met; and, until 1 January 2030, natural gas and wood used as firewood; (23) live plants and other floricultural products, including bulbs, cotton, roots and the like, cut flowers and ornamental foliage; (24) children's clothing and footwear; the supply of children's car seats; (25) the supply of bicycles, including electric bicycles; and rental and repair services with respect to bicycles; (26) the supply of works of art, collectors' items and antiques listed in Annex IX, Parts A, B and C of the VATD; (27) legal services supplied to people under a work contract and unemployed people in labor court proceedings, and legal services supplied under the legal aid scheme, as defined by the Member States; (28) tools and other equipment of a kind normally intended for use in rescue or first aid services when supplied to public bodies or non-profit organizations active in the field of civil or community protection; (29) the supply of services in connection with the operation of lightships, lighthouses or other navigational aids and life-saving services, including the organization and maintenance of the lifeboat service.

(2) Reduced Rates Below 5% Minimum Reduced Rate (Super-Reduced Value Added Tax Rates)

Member States may, in addition to the two reduced rates referred to in XVII.H.2.b.(1), above, apply a reduced rate lower than the minimum 5% and an exemption with deductibility of the VAT paid at the preceding stage to supplies of goods or services covered, but only in a maximum of seven points in Annex III to the VATD and only with respect to the points in Annex III explicitly referred to in Article 98 (2) of the VATD.

Member States that, on January 1, 2021, apply reduced rates lower than the minimum 5% or granting exemptions with

¹³⁶⁷ The supply, importation and acquisition of racehorses do not fall within the scope of this category: see Case C-41/09, *Commission v. Netherlands*; Case C-441/09, *Commission v. Austria*; Case C-453/09, *Commission v. Germany*; Case C-156/10, *Commission v. France*.

¹³⁶⁸ Case C-703/19, *Dyrektor Izby Administracji Skarbowej w Katowicach*: the concept of "restaurant and catering services" includes the supply of food accompanied by sufficient support services intended to enable the immediate consumption of the food by the end customer; if the end customer chooses not to benefit from the material and human resources made available by the taxable person to accompany the consumption of the food supplied, it must be concluded that no support services accompany the supply of that food.

¹³⁶⁹ Case C-432/15, *Baštová*: the reduced VAT rate may not be applied to a single composite supply of services, made up of several components relating, *inter alia*, to the training of horses, the use of sporting facilities and the stabling, feeding and other care provided to the horses where the use of the sporting facilities, within the meaning of VATD, Annex III, point 14, and the training of the horses constitute two components of that composite supply having equal status, or where the training of the horses constitutes the main component of the supply. In the same vein, in Case C-330/21, *The Escape Center*, the CJEU held, on September 22, 2022, that VATD Art. 98(2), read in conjunction with Annex III, point (14), must be interpreted as meaning that the supply of services consisting of permission to use sporting facilities in a fitness center and the supply of individual or group coaching may be subject to a reduced rate of VAT where the coaching is linked to the use of the facilities and is necessary for the practice of sports and physical education or where the coaching is ancillary to the actual use of the facilities (composite or single supply).

¹³⁷⁰ Although Member States have a margin of discretion as to whether to recognize certain organizations as being devoted to social wellbeing, such discretion must be exercised in accordance with EU law and, in particular, within the limits laid down in the VATD (Case C-141/00 *Kügler*; Case C-498/03, *Kingscrest Associates and Montecello*; Case C-415/04 *Stichting Kinderopvang Enschede*). In that regard, it is clear from its wording that Annex III, point (15) permits Member States to apply a reduced rate of VAT not to all supplies of services related to social wellbeing, but only to services provided by organizations that meet the dual requirement of being themselves devoted to social wellbeing and being engaged in welfare or social security work — in light of its overall objectives and the fact that any engagement in welfare work is not permanent, the professional category of lawyers as a whole (at issue were sup-

plies of services by French *avocats*, *avocats au Conseil d'Etat et à la Cour de Cassation* and *avoués*, for which they are paid in full or in part by the State under a legal aid scheme) cannot be regarded as devoted to social wellbeing (Case C-492/08, *Commission v. France*).

¹³⁷¹ Case C-94/09, *Commission v. France*: the transportation of a body by vehicle constitutes a concrete and specific element in the supply of services by undertakers.

deductibility of the VAT paid at the preceding stage to supplies of goods or services covered in more than seven points in Annex III to the VATD are allowed to continue to do so. It is understood, however, that Member States must limit the application of those reduced rates or the granting of those exemptions by January 1, 2032 or by the adoption of the definitive arrangements referred to in Article 402 of the VATD (definitive EU VAT regime), whichever is earlier.

(3) *Electronically Supplied Services*

The reduced rates and the exemptions referred to in XVII.H.2.b.(1) and (2), above do not apply to electronically supplied services, except to those listed in Annex III, points (6), (7), (8) and (13) of the VATD (see XVII.H.2.b.(1), above).

3. *Exceptional Situations*

If authorized by the Commission to apply an exemption to goods imported for the benefit of disaster victims, the relevant Member State may grant an exemption with deductibility of the VAT paid at the preceding stage under the same conditions, with respect to intra-EU acquisitions and the supply of goods and services related to such goods, including rental services.¹³⁷²

4. *Particular Provisions — Special Provisions Applying Until the Adoption of Definitive Arrangements*

See Articles 103 through 105b of the VATD providing for certain transitional (and derogatory) measures.

I. *Exemptions*

1. *General*

Title IX of the VATD lists the exemptions from VAT. The exemptions apply without prejudice to other EU provisions and in accordance with conditions that the Member States lay down for purposes of ensuring the correct and straightforward application of the exemptions and preventing any possible evasion, avoidance or abuse.¹³⁷³ They constitute independent concepts of EU law whose purpose is to avoid divergences in the application of the VAT system from one Member State to another.¹³⁷⁴ The terms used to specify the exemptions are to be interpreted strictly, since they constitute exceptions to the general principle that VAT is to be levied on all services supplied for consideration by a taxable person.¹³⁷⁵ Nevertheless, the interpretation of the terms must be consistent with the objectives pursued by the exemptions and comply with the requirements of the principle of fiscal neutrality inherent in the common system of VAT.¹³⁷⁶ Thus, while the exemptions must be strictly interpreted, this does not mean that they should be interpreted restrictively in such a way as to whittle them away by interpretation only¹³⁷⁷ or

to deprive them of their intended effect.¹³⁷⁸ Although Member States are to lay down the conditions for the exemptions to ensure their correct and straightforward application and to prevent any possible evasion, avoidance or abuse, those conditions cannot affect the definition of the subject matter of the exemptions envisaged.¹³⁷⁹ From that point of view, whether a specific transaction is subject to or exempt from VAT cannot depend on its classification in national law.¹³⁸⁰

The VATD distinguishes between: (i) exemptions carrying no right to deduct (Articles 132–137 of the VATD); and (ii) exemptions carrying a right to deduct (Articles 138–166 of the VATD).

2. *Exemptions Without Right to Deduct*

Exemptions carrying a right to deduct include: (i) exemptions for activities in the public interest (Articles 132–134 of the VATD); and (ii) exemptions for other activities (Articles 135–137 of the VATD).¹³⁸¹

In the case of these types of exemptions, contrary to what the use of the word “exemption” might indicate, being exempt actually entails significant VAT costs. Under Article 168 of the VATD, VAT paid on input transactions is only deductible “insofar as the goods and services are used for the purposes of the taxed transactions of a taxable person.” Thus, where VAT is paid in connection with exempt supplies falling within this category, it will not, in principle (i.e., subject to the exceptions set out in Article 169 of the VATD), be deductible, resulting in what may potentially be a considerable tax cost.

a. *Exemptions for Activities in the Public Interest*

Exemptions for activities in the public interest are discussed in XVII.I.2.a.(1) to XVII.I.2.a.(17), below.¹³⁸²

¹³⁷⁸ Case C-445/05, *Haderer*.

¹³⁷⁹ Case C-287/00, *Commission v. Germany*.

¹³⁸⁰ Case C-76/99, *Commission v. France*; Case C-315/00, *Maierhofer*.

¹³⁸¹ Exemptions (without credit) have been referred to as the “original sin” of the VAT system (see, Opinion of Advocate General Colomer in Case C-498/03, *Kingscrest Associates and Montecello*). Proponents of this thesis argue that because of the corresponding denial of a deduction for input VAT, such exemptions have a similar effect to reduced rates, but in addition cause significant distortions and complexity in that they may undermine efficiency gains that could be obtained by outsourcing back-office activities in exempt sectors; they raise administrative and compliance costs by requiring the complex allocation of input VAT in the case of mixed businesses (i.e., business making both exempt and taxable supplies); they fuel tax planning, etc.

¹³⁸² Member States may make the granting to bodies other than those governed by public law of each exemption set out at XVII.I.2.a.(2), (7), (8), (9), (12), (13) and (14) subject in each individual case to one or more of the following conditions: (i) the bodies in question may not systematically aim to make a profit, and any surpluses nevertheless arising may not be distributed, but must be assigned to the continuance or improvement of the services supplied; (ii) those bodies must be managed and administered on an essentially voluntary basis by persons that have no direct or indirect interest, either themselves or through intermediaries, in the results of the activities concerned; (iii) the bodies in question must charge prices that are approved by the public authorities or that do not exceed those approved prices or, with respect to services that are not subject to approval, prices lower than those charged for similar services by commercial enterprises subject to VAT; and (iv) the exemptions must not be likely to cause distortion of competition to the disadvantage of commercial enterprises subject to VAT. With regard to the same points, an exemption is not to be granted with respect to the supply of goods or services where the supply is not essential to the transactions exempted or where the basic purpose of the supply is to obtain additional income for the body in question through transac-

¹³⁷² VATD, Art. 101a.

¹³⁷³ VATD, Art. 131.

¹³⁷⁴ Case C-349/96, *Card Protection Plan*; Case C-240/99, *Skandia*; and Joined Cases C-394/04 and C-395/04, *Ygeia*.

¹³⁷⁵ Case C-287/00, *Commission v. Germany*; Case C8/01, *Taksatorringen*.

¹³⁷⁶ Case C-45/01, *Dornier*; Case C-498/03, *Kingscrest Associates and Montecello*; and Case C-106/05, *L.u.p.*

¹³⁷⁷ Opinion of Advocate General Jacobs in Case C-267/00, *Zoological Society of London*.

(1) *Public Postal Services*

The supply by public postal services of services other than passenger transportation and telecommunications services, and the supply of goods incidental to such services, are exempt from VAT.¹³⁸³

“Public postal services” covers operators, whether public or private, that undertake to provide, in a Member State, all or part of the universal postal service. The exemption applies to the supply, by public postal services acting as such (that is, in their capacity as operators that undertake to provide all or part of the universal postal service in a Member State), of services other than passenger transportation and telecommunications services, and the supply of goods incidental to such services.¹³⁸⁴

(2) *Hospital and Medical Care and Closely Related Activities*

Hospital and medical care and closely related activities undertaken by bodies governed by public law or, under social conditions comparable to those applicable to bodies governed by public law, by hospitals, centers for medical treatment or diagnosis, and other duly recognized establishments of a similar nature are exempt from VAT.¹³⁸⁵

The hospital and medical care envisaged by this exemption has as its purpose the diagnosis, treatment and, insofar as is possible, cure of diseases or health disorders.¹³⁸⁶

In *PFC Clinic AB*¹³⁸⁷, the CJEU held that supplies of services consisting of plastic surgery and other cosmetic treatments fall within the concept of “medical care” (and “the provision of medical care” — see XVII.1.2.a.(3), below) where the services are intended to diagnose, treat or cure diseases or health disorders or to protect, maintain or restore human health; the subjective understanding that a person who undergoes plastic surgery or a cosmetic treatment has of it is not in itself decisive for purposes of determining whether that intervention has a therapeutic purpose; however, the fact that the services are supplied or undertaken by a licensed member of the medical profession or that their purpose is determined by such a professional may influence the assessment of whether such interventions fall within the scope of the exemption.

“Closely related activities” are supplies of services that are logically part of the provision of hospital and medical-care services, and that constitute an indispensable stage in the process of the supply of those services in achieving their therapeutic objectives; only such services are of a nature to influence the cost of the health care that is made accessible to individuals by the exemption in question.¹³⁸⁸

According to the CJEU, as a rule, the supply of telephone services and the hiring out of televisions to in-patients do not

amount to activities closely related to hospital and medical care.¹³⁸⁹

Also, the transportation, for clinics and laboratories, of human organs and samples of human origin for purposes of medical analysis or medical or therapeutic care, by a third party who is self-employed and whose services are covered by the reimbursement made by the social security system, does not qualify for an exemption from VAT as an activity closely related to services of a medical nature — this is because the self-employed third party cannot be characterized as a “body governed by public law” or fall within the definition of a “hospital,” a “center for medical treatment,” a center for “diagnosis” or any “other duly recognized establishment of a similar nature,” operating under social conditions comparable to those applicable to bodies governed by public law.¹³⁹⁰

On the other hand, an activity consisting of compiling an individual file, including the user’s clinical record, that entitles the user to purchase “traditional thermal cure” medical care within a spa establishment is liable to be within the scope of the exemption from VAT provided for in Article 132(1)(b) of the VATD as an activity closely related to medical care, where the files set out data relating to the user’s state of health, and planned and prescribed medical care, as well as the manner in which that care is to be administered, that must be consulted for the provision of care and to achieve the therapeutic objectives pursued. That medical care and activities closely related to it must also be undertaken, under social conditions comparable to those applicable to bodies governed by public law, by a center for medical treatment or diagnosis or by another duly recognized establishment of a similar nature within the meaning of Art. 132(1)(b).¹³⁹¹

(3) *Provision of Medical Care in the Exercise of Medical and Paramedical Professions*

The provision of medical care in the exercise of the medical and paramedical professions (as defined by the Member State concerned) is exempt from VAT.¹³⁹² Not all services that may be performed in the exercise of the medical and paramedical professions are covered by this exemption, only the “provision of medical care.”¹³⁹³

It follows that only medical care provided in the exercise of the medical and paramedical professions, outside a hospital setting, for purposes of prevention, diagnosis or treatment qualifies for exemption, to the exclusion of other activities relating to general care and domestic help.¹³⁹⁴

In *X*,¹³⁹⁵ the CJEU held that services provided by telephone, consisting of giving advice regarding health and illnesses, are capable of falling within the scope of the exemption, provided the services have a therapeutic purpose that is not

tions that are in direct competition with those of commercial enterprises subject to VAT (VATD, Arts. 133 and 134).

¹³⁸³ VATD, Art. 132(1)(a).

¹³⁸⁴ Case C-357/07, *TNT Post UK Ltd.*

¹³⁸⁵ VATD, Art. 132(1)(b).

¹³⁸⁶ Case C-45/01, *Dornier*.

¹³⁸⁷ Case C-91/12, *PFC Clinic AB*.

¹³⁸⁸ Joined Cases C-394/04 and 395/04, *Ygeia*.

¹³⁸⁹ Joined Cases C-394/04 and 395/04, *Ygeia*.

¹³⁹⁰ Case C-334/14, *De Fruytier*.

¹³⁹¹ Case C-513/20, *Termas Sulfurosas de Alcafache SA*.

¹³⁹² VATD, Art. 132(1)(c).

¹³⁹³ Case C-212/01, *Margarete Unterpertinger*; see also Case 122/87, *Commission v. Italy*; the term “medical and paramedical professions” does not include the activities of veterinary surgeons.

¹³⁹⁴ Case C-141/00, *Ambulanter Pflegedienst Kögler GmbH*. See, however, for general care and domestic help: VATD, Art. 132(1)(g), discussed at XVII.1.2.a.(7).

¹³⁹⁵ Case C-48/19, *X*.

confined within a particularly narrow compass; thus, medical services provided for purposes of protecting, including maintaining or restoring, human health may benefit from the exemption under Article 132(1)(c) of the VATD.¹³⁹⁶

(4) Supply of Human Organs, Blood and Milk

The supply of human organs, blood and milk is exempt from VAT.¹³⁹⁷

Supplies of human blood, which Member States are required to exempt under Article 132(1)(d) of the VATD, do not include supplies of plasma obtained from human blood where the plasma is intended to be used, not for direct therapeutic purposes, but exclusively for the manufacture of medicinal products.¹³⁹⁸

The activity of transporting human organs and samples cannot benefit from the exemption since such activity merely involves physically moving the goods concerned from one place to another for various hospitals and laboratories and thus no “supply.”¹³⁹⁹

(5) Services of Dental Technicians — Dental Prostheses

The supply of services by dental technicians in their professional capacity and the supply of dental prostheses by dentists and dental technicians are exempt from VAT.¹⁴⁰⁰

(6) Independent Groups of Persons — Cost-Sharing

The supply of services by an independent group of persons (IGP) carrying on an activity that is exempt from VAT, or in relation to which it is not a taxable person, for purposes of rendering to its members the services directly necessary for the exercise of that activity, where the IGP merely claims from its members an exact reimbursement of their share of the joint expenses, is exempt from VAT, provided the exemption is not likely to cause distortion of competition.¹⁴⁰¹

The exemption does not apply to supplies of services made by an IGP to a group of persons that may be regarded as a single taxable person, within the meaning of Article 11 of VATD (i.e., a VAT grouping, see XVII.C.2.c., above), where not all the members of that latter group are members of that IGP. This is because the existence of provisions of national law requiring the representative member of such a group of persons to possess the characteristics and status of the members of the IGP concerned, for purposes of the application of the exemption for IGP, has no bearing in that regard.¹⁴⁰²

An IGP is a taxable person in its own right, separate from its members, who are also taxable persons. Consequently, transactions between an IGP, which acts independently, and one of its members are to be regarded as transactions between

two taxable persons falling within the scope of VAT — hence, the allocation to the IGP, by one of its members, of expenses incurred by that member in his or her name but on behalf of the IGP is a transaction that falls within the scope of VAT.¹⁴⁰³

Qualifying services supplied to its members by an IGP are covered by the exemption, even if those services are supplied to one member or a number of, rather than all, members.¹⁴⁰⁴

The CJEU initially seemed to regard the Article 132(1)(f) of the VATD exemption as having relatively wide application. In *Taksatorringen*,¹⁴⁰⁵ the CJEU ruled that the exemption under Article 132(1)(f) could be denied if there was a genuine risk that it might give rise to distortion of competition. In this decision, however, the Court did not rule on whether the exemption provided for in Article 132(1)(f) was limited to the services supplied by an IGP whose members carried on activities in the public interest. Three decisions of September 21, 2017 answer this question in the affirmative. In *DNB Banka*,¹⁴⁰⁶ the CJEU points out that Article 132(1)(f) is included in Chapter 2 of Title IX of that directive, which is entitled “Exemptions for certain activities in the public interest.” This heading indicates that the exemption provided for in that provision refers only to IGPs whose members carry on activities in the public interest. According to the Court, this interpretation is also confirmed by the structure of Title IX of the VATD relating to “Exemptions,” i.e., within the VATD, Article 132(1)(f) is included, not in Chapter 1 of the VATD, which is entitled “General Provisions,” but in Chapter 2. Moreover, in the VATD, a distinction is made between Chapter 2, which is entitled “Exemptions for certain activities in the public interest” and Chapter 3, which is entitled “Exemptions for other activities,” a distinction that indicates that the rules laid down in Chapter 2 for certain activities in the public interest do not apply to the other activities referred to in Chapter 3. Since the purpose of all of the provisions of Article 132 is to exempt from VAT certain activities in the public interest with a view to facilitating access to certain services and the supply of certain goods by avoiding the increased costs that would result if they were subject to VAT,¹⁴⁰⁷ services provided by an IGP come within the exemption provided for in Article 132(1)(f) where the provision of those services contributes directly to the exercise of activities in the public interest referred to in Article 132.¹⁴⁰⁸ Accordingly, Article 132(1)(f) should be interpreted to the effect that the exemption it provides for relates only to IGPs whose members carry on activities in the public interest as referred to in that article. Therefore, services provided by IGPs whose members carry on an economic activity in the area of financial services, which does not constitute an activity in the public interest, are not entitled to the exemption. Likewise, in *Aviva*,¹⁴⁰⁹ the CJEU held that services provided by IGPs whose members carry on an economic activity in the area of insurance, which does not constitute an activity in the public interest, are not entitled to the exemption provided

¹³⁹⁶ See Case C-86/09, *Future Health Technologies* and Case C-91/12, *PFC Clinic*.

¹³⁹⁷ VATD, Art. 132(1)(d).

¹³⁹⁸ See Case C-412/15, *TMD*.

¹³⁹⁹ Case C-237/09, *De Fruytier*.

¹⁴⁰⁰ VATD, Art. 132(1)(e).

¹⁴⁰¹ VATD, Art. 132(1)(f).

¹⁴⁰² Case C 77/19, *Kaplan International Colleges UK Ltd*, in which the main issue was whether a cost sharing group established in a non-EU jurisdiction, such as Hong Kong, can benefit from the cost sharing exemption.

¹⁴⁰³ Case C-274/15, *Commission v. Luxembourg*.

¹⁴⁰⁴ Case C-407/07, *Stichting Centraal Begeleidingsorgaan voor de Intercollegiale Toetsing*.

¹⁴⁰⁵ Case C-8/01, *Taksatorringen*.

¹⁴⁰⁶ Case C-326/15, *DNB Banka*.

¹⁴⁰⁷ See, to that effect, Case C-412/15, *TMD*.

¹⁴⁰⁸ See, by analogy, Case C-412/15, *TMD*.

¹⁴⁰⁹ Case C-605/15, *Aviva*.

for in Article 132(1)(f). Finally, in *Commission v. Germany*,¹⁴¹⁰ the CJEU reiterated its position that supplies of services by an IGP are covered by the exemption in Article 132(1)(f) where those supplies directly contribute to activities in the public interest.

It follows from this (reversal of) case law that the VAT exemption in Article 132(1)(f) of the VATD can no longer be applied by companies in the financial sector, including banks and insurance companies or by a range of companies with activities involving shares and real estate, even though such activities are mainly VAT-exempt or fall outside the scope of VAT. In the September 21, 2017 rulings, the CJEU acknowledged that this (new) interpretation constitutes a significant departure from its ruling in *Taksatorringen* and, hence, decided that its (revised) position was not to apply retroactively.

In *Kaplan International Colleges UK*,¹⁴¹¹ the CJEU held that the exemption is not applicable to supplies of services made by an IGP to a group of persons that may be regarded as a single taxable person, where not all the members of that latter group are members of the IGP. The existence of provisions of national law requiring the representative member of such a group of persons to possess the characteristics and status of the members of the IGP concerned, for purposes of the application of the exemption for IGPs, has no bearing in that regard.

(7) Welfare and Social Security Work

Supplies of services and goods closely linked to welfare and social security work, including those supplied by old people's homes, bodies governed by public law and other bodies recognized by the Member State concerned as being devoted to social wellbeing are exempt from VAT.¹⁴¹²

The express reference to "bodies" implies that the exemption may be claimed only by legal persons. Consequently, a trader who is a natural person cannot claim the exemption.¹⁴¹³

The provision of general care and domestic help by an outpatient care service to persons in a state of physical or economic dependence amounts to the supply of services closely linked to welfare and social security work within the meaning of the exemption.¹⁴¹⁴ Services provided by a serviced residence consisting of the provision of dwellings adapted for elderly persons may benefit from the exemption; the other services provided by that serviced residence may also benefit from the exemption, provided in particular that the services that serviced residences are obliged to offer under the relevant national legislation are intended to achieve the support and care of elderly persons and correspond to the services that old people's homes are also obliged to offer under national legislation. It is irrelevant in this respect whether the operator of a serviced residence receives a subsidy or any other form of advantage or financial support from public authorities.¹⁴¹⁵

(8) Protection of Children

The supply of services and goods closely linked to the protection of children and young persons by bodies governed by public law or by other organizations recognized by the Member State concerned as being devoted to social wellbeing is exempt from VAT.¹⁴¹⁶

(9) Education

The provision of children's or young people's education, school or university education, vocational training or retraining, including the supply of services and goods closely related thereto, by bodies governed by public law that have this as their aim or by other organizations recognized by the Member State concerned as having similar objects is exempt from VAT.¹⁴¹⁷

According to the CJEU, for purposes of the VAT system, the concept of "school or university education" refers generally to an integrated system for the transfer of knowledge and skills covering a wide and diversified set of subjects, and to the furthering and development of that knowledge and those skills by the pupils and students in the course of their progress and their specialization in the various constituent stages of that system. The concept does not cover motor vehicle driving tuition provided by a driving school for purpose of acquiring a driver's license for vehicles in categories B and C1 referred to in Article 4(4) of Directive 2006/126/EC of the European Parliament and of the Council of December 20, 2006, on driving licenses.¹⁴¹⁸

Activities consisting of students at a higher education establishment supplying, for consideration and as part of their education, restaurant and entertainment services to third parties, may be regarded as supplies "closely related" to the principal supply of education and accordingly be exempt from VAT, provided the services are essential to the students' education and their basic purpose is not to obtain additional income for the establishment by carrying out transactions that are in direct competition with those of commercial enterprises liable for VAT.¹⁴¹⁹

Although the importance of the knowledge transferred in the context of driving and sailing tuition cannot be denied, in particular to deal with emergency situations and, more generally, to ensure the safety and physical integrity of persons, the CJEU has nevertheless held that such tuition does not fall within the scope of the concept of "school or university education" within the meaning of Article 132(1)(i) (and (j), see below) of the VATD.¹⁴²⁰ In the same vein, the Court held in *Dubrovín & Troger GbR — Aquatics*,¹⁴²¹ a case that concerned a swimming school in the form of a partnership governed by public law offering swimming tuition to children, that the concept of "school or university education," within the meaning of Article 132(1)(i) (and (j), see XVII.1.2.a.(10), below) of the VATD, must be interpreted as not covering swimming tuition provided by a swimming school.

¹⁴¹⁰ Case C-616/15, *Commission v. Germany*.

¹⁴¹¹ Case C-77/19, *Kaplan International Colleges UK*.

¹⁴¹² VATD, Art. 132(1)(g). See Case C-543/14, *Ordres des barreaux*: services supplied by lawyers to clients who qualify for legal aid under a national legal aid scheme are not exempt from VAT.

¹⁴¹³ Case C-453/93, *Bulthuis-Griffioen*.

¹⁴¹⁴ Case C-141/00, *Ambulanter Pflegedienst Kugler GmbH*.

¹⁴¹⁵ Case C-335/14, *Les Jardins de Jouvence*; see also Case C-498/03, *Kingscrest Associates and Montecello*, and Case C-174/11, *Zimmermann*.

¹⁴¹⁶ VATD, Art. 132(1)(h).

¹⁴¹⁷ VATD, Art. 132(1)(i).

¹⁴¹⁸ Case C-449/17, *A & G Fahrschul-Akademie GmbH*.

¹⁴¹⁹ Case C-699/15, *Brockenhurst College*.

¹⁴²⁰ Case C-449/17, *A & G Fahrschul-Akademie*; Order in Case C-47/19, *Finanzamt Hamburg-Barmbek-Uhlenhorst*.

¹⁴²¹ Case C-373/20, *Dubrovín & Troger GbR — Aquatics*.

(10) *Tuition*

Tuition provided privately by teachers and covering school or university education is exempt from VAT.¹⁴²² See also the discussion above at XVII.I.2.a.(9), above.

(11) *Supply of Staff by Religious or Philosophical Institutions*

The supply of staff by religious or philosophical institutions for purpose of the activities referred to at XVII.I.2.a.(2), (7), (8) and (9), above, and with a view to spiritual welfare is exempt from VAT.¹⁴²³

(12) *“Trade Union” Exemption*

The supply of services, and the supply of goods closely linked to such services, by a non-profit organization to its members in their common interest in return for a subscription fixed in accordance with its rules, where the aims of the organization are of a political, trade-union, religious, patriotic, philosophical, philanthropic or civic nature, are exempt from VAT provided the exemption is not likely to cause distortion of competition.¹⁴²⁴

(13) *Sport or Physical Education*

The supply of certain services closely linked to sports or physical education by non-profit organizations to persons taking part in sports or physical education is exempt from VAT.¹⁴²⁵

In *Golfclub Schloss Igling*,¹⁴²⁶ the CJEU made it clear that since the wording of Article 132(1)(m) of the VSTD provides that Member States are to exempt *certain* services — and not, *all* services — closely linked to the practice of sport, Member States enjoy a certain discretion in the matter. They can accordingly determine which services related to the practice of sport or physical education provided by non-profit organizations they wish to exempt. The exemption has no direct effect.

(14) *Cultural Services*

The supply of certain cultural services, and the supply of goods closely linked to such services, by bodies governed by public law or by other cultural bodies recognized by the Member State concerned is exempt from VAT.¹⁴²⁷

(15) *Fund Raising*

The supply of services and goods, by organizations whose activities are exempt as described in XVII.I.2.a.(2), (7), (8), (9), (12), (13) and (14), above, in connection with fund-raising events organized exclusively for their own benefit is exempt from VAT provided the exemption is not likely to cause dis-

tortion of competition.¹⁴²⁸ Member States may introduce any restrictions necessary, in particular as regards the number of events or the amount of receipts necessary to qualify for the exemption.¹⁴²⁹

(16) *Transportation Services for Sick or Injured Persons*

The supply by duly authorized bodies of transportation services for sick or injured persons in vehicles specially designed for the purpose is exempt from VAT.¹⁴³⁰

(17) *Public Radio and Television*

Activities, other than those of a commercial nature, carried on by public radio and television bodies are exempt from VAT.¹⁴³¹

b. Exemptions for Other Activities

Exemptions for other activities (not carrying a right to deduct) include exemptions for: (i) insurance and reinsurance transactions (Article 135(1)(a) of the VATD) and financial transactions (Article 135(1)(b)–(g) of the VATD); (ii) the supply of postage stamps, fiscal stamps and other similar stamps (Article 135(1)(h) of the VATD); (iii) betting, lotteries and other forms of gambling (Article 135(1)(i) of the VATD); and (iv) certain supplies with respect to immovable property, i.e., supplies of buildings and land, and the leasing and letting of immovable property (Article 135(1)(j)–(l) of the VATD).

(1) *Insurance and Reinsurance Transactions*

Insurance and reinsurance transactions, including related services performed by insurance brokers and insurance agents, are exempt under Article 135(1)(a) of the VATD.

Centering around five variables, i.e., “insurance” and “reinsurance” transactions, “related services” and insurance “brokers” and “agents,” concepts that are not further defined (in the VATD), the provision is rather vague and its scope of application quite unclear. While the CJEU has been instrumental in shedding some light in this complex area, uncertainties remain.

In *Card Protection Plan*,¹⁴³² the seminal case as regards mixed and composite supplies (see XVII.D.1.d., above), the issue at hand was whether a contract for the provision of a range of credit card protection services amounted to a (single) “insurance transaction” within the meaning of Article 135(1)(a) of the VATD. The CJEU made it clear that the essentials of an insurance transaction are, as generally understood, that the insurer undertakes, in return for prior payment of a premium, to provide the insured, in the event of the materialization of the risk covered, with the service agreed to when the contract was entered into. The CJEU concluded that the “protection plan” offered by Card Protection Plan to its customers constituted an insurance transaction within the meaning of Article 135(1)(a). The Court justified its decision by reasoning that, despite the need for the strict interpretation of VAT exemptions and the status of such exemptions as independent concepts of EU

¹⁴²² VATD, Art. 132(1)(j). See the CJEU case law referred to in the two previous footnotes.

¹⁴²³ VATD, Art. 132(1)(k).

¹⁴²⁴ VATD, Art. 132(1)(l). See Case C-149/97, *Institute of the Motor Industry*.

¹⁴²⁵ VATD, Art. 132(1)(m).

¹⁴²⁶ Case C-488/18, *Golfclub Schloss Igling*.

¹⁴²⁷ VATD, Art. 132(1)(n). See, Case C-592/15, *British Film Institute*: this provision must be interpreted as not having direct effect, so that in the absence of transposition it may not be relied on directly by a body governed by public law or any other cultural body recognized by the Member State concerned that supplies cultural services.

¹⁴²⁸ VATD, Art. 132(1)(o).

¹⁴²⁹ VATD, Art. 132(2).

¹⁴³⁰ VATD, Art. 132(1)(p).

¹⁴³¹ VATD, Art. 132(1)(q).

¹⁴³² Case C-349/86, *Card Protection Plan*.

law, the expression “insurance transactions” is broad enough in principle to include the provision of insurance cover by a taxable person that is not itself an insurer. In other words, the identity of the persons effecting the transactions is irrelevant in determining what transactions are exempt under Article 135(1) (a), meaning that such transactions are defined in terms of the nature of the services provided and not in terms of the person supplying or receiving the services.¹⁴³³ The CJEU broadened the scope of the provision still further by indicating that it is not essential that the services the insurer has undertaken to provide in the event of a loss consist of the payment of a sum of money, as those services may also take the form of the provision of assistance in cash or in kind of the types listed in the annex to the First Non-Life Directive (73/239/EEC) (as amended).

Given that risk assumption is essential to insurance transactions, the CJEU determined that it is important for the service provider to have a contractual relationship with the insured persons.¹⁴³⁴ Thus, a cooperative agreement under which one insurance company runs the business of another for remuneration, but without concluding the insurance contracts in its own name or assuming the related liabilities, is not an insurance transaction within the meaning of Article 135(1)(a) of the VATD, but instead a service effected for consideration that is subject to VAT.¹⁴³⁵

The term “insurance transactions,” as used in the VAT exemption, includes transactions carried out by the insurer that assumes the risk, as well as the provision of insurance coverage by a taxable person that, while not an insurer, purchases coverage for its customers through an insurer that then assumes the risks. Despite the broad meaning of insurance transactions, the term implies the existence of a contractual relationship between the insurance provider and the insured. Consequently, the transfer, for consideration, of life reinsurance contracts that includes payment in return for acquiring those contracts (the transfer qualifying as a supply of services, since life reinsurance contracts are not tangible property) lacks the characteristics of an insurance transaction and can therefore not be characterized as a VAT-exempt insurance transaction; nor can it qualify as a VAT-exempt reinsurance transaction as, according to the CJEU, a reinsurance transaction is a transaction in which a (re)insurer concludes a contract under which it undertakes to assume, in return for payment of a premium, contractual obligations of another insurer (whereas, in the case at issue, the transferee assumed all the rights and obligations under the transferred contracts and the transferor no longer had any legal relationship with the reinsured persons following the transfer of the portfolio).¹⁴³⁶

Investment fund management services supplied for an occupational pension scheme that do not provide any indemnity from risk cannot be classified as “insurance transactions” and thus do not fall within the VAT exemption for such transactions.¹⁴³⁷

¹⁴³³ A similar approach has been adopted as regards the interpretation of the exemption applicable to financial transactions: see Case C-2/95, *SDC*.

¹⁴³⁴ Case C-240/99, *Skandia*; see also Case C-8/01, *Taksatorringen*.

¹⁴³⁵ Case C-240/99, *Skandia*.

¹⁴³⁶ Case C-242/08, *Swiss Re Germany Holding*. The CJEU added that the transfer of a portfolio of reinsurance contracts could also not qualify as a VAT-exempt financial transaction as, in the view of the CJEU, such a transfer was “by its nature” not a financial transaction within the meaning of the VATD.

In *BGZ*,¹⁴³⁸ which concerned a Polish car leasing company, the lessee paid a rent to the lessor as well as other expenses and charges. BGZ required the leased cars to be insured and offered to arrange insurance through an insurance provider selected by BGZ. If the client accepted, BGZ concluded the agreement with the insurance provider and re-invoiced exactly the same amount for the insurance. According to the CJEU, the supply clearly consisted of two elements, the leasing and the insurance, which were likely to be supplied together. Furthermore, the insurance services provided could not be regarded as being ancillary to the leasing service because the insurance essentially constituted an end result for the lessee and not only a means of better enjoying the leasing service.

The CJEU added that the separate invoicing and pricing of the services supported the view that the services were independent of each other but was not decisive. In conclusion, the CJEU confirmed that such insurance services, which constituted an independent supply and an end result for the lessee, should not be considered part of the taxable amount of the leasing service. Moreover, since the VAT treatment of directly supplied insurance services should not be affected when they are recharged for the same amount, the CJEU concluded that, in the context of a lease, a re-invoicing transaction that consists of the exact cost of insurance for the leased item constitutes an insurance transaction that is exempt from VAT.

In *Generali Seguros*,¹⁴³⁹ the CJEU held that Article 135(1) (a) of the VATD must be interpreted to mean that transactions consisting of the sale by an insurance undertaking to third parties of parts from written-off motor vehicles that have been involved in accidents covered by that undertaking and that it has purchased from the persons whom it insures do not fall within the scope of that provision. The reason is that the sales of the parts from written-off motor vehicles at issue were the result of agreements\separate from the insurance contracts covering those vehicles and were concluded by the insurance undertaking with persons other than the insured persons. Moreover, the original owners of those vehicles were not obliged to transfer those parts to that undertaking. As such, the decision of those insured persons was independent of the insurance contracts and was made after the contracts had been concluded, and even after the materialization of the risk covered. Thus, referring to *BGZ Leasing* (see above), it cannot be held that the fact that sales such as those at issue are made by an insurance undertaking and relate to parts from written-off motor vehicles that have been involved in accidents covered by the undertaking means that those sales and the insurance contracts relating to those vehicles are so closely linked that objectively, from an economic point of view, they form a whole that it would be artificial to split.

No definition is provided of “broker” or “agent,” nor of “related services,” although it is clear that they must be insurance-related. In *Arthur Andersen*,¹⁴⁴⁰ the CJEU narrowed the application of the exemption considerably. The issue was whether various “back office” services provided by Arthur An-

¹⁴³⁷ Case C-235/19, *United Biscuits (Pensions Trustees) and United Biscuits Pension Investments*.

¹⁴³⁸ Case C-224/11, *BGZ Leasing*.

¹⁴³⁹ Case C-42/22, *Generali Seguros*.

¹⁴⁴⁰ Case C-472/03, *Arthur Andersen*.

dersen to a life insurance company were exempt from VAT. These included accepting applications; issuing, managing and canceling insurance policies; managing claims; and providing management information. In carrying out these tasks, the company had the authority to make decisions that were binding on the insurer. For its services to fall within the scope of VAT-exempt insurance intermediary services, it was necessary for Arthur Andersen to be acting either as an insurance broker or as an insurance agent. For this purpose, it was not necessary for Andersen to be regulated as such — it just had to exhibit the essential characteristics of either a broker or an agent. The CJEU held that Arthur Andersen was not acting as an insurance broker because an essential characteristic of a broker is that it has complete freedom of choice of insurer for its client. Nor was it acting as an insurance agent, as an insurance agent must be instrumental in bringing the concerned parties together. Without that, Arthur Andersen was merely assisting the insurer in carrying out various tasks the insurer would otherwise have to perform itself. The fact that it had the authority to make decisions binding on the insurer was not necessarily the determining factor. Hence, the VAT exemption did not apply.¹⁴⁴¹ Of particular note was the fact that the CJEU rejected the United Kingdom's historic lynch pin of exemption, namely a delegated authority to bind the insurer.

It follows from this case law that outsourced and sub-contracted insurance-related services will, almost always, fall outside the scope of the insurance services exemption and will thus be deemed to be taxable. On the other hand, a sub-agent that has only an indirect (rather than a direct) contractual relationship with an insurer should be able to benefit from the VAT exemption for insurance transactions: the fact that an insurance broker or agent does not have a direct relationship with the parties to the insurance or reinsurance contract in the conclusion of which it has been instrumental, but merely an indirect relationship with them through the intermediary of another taxable person that is, itself, in a direct relationship with one of those parties, and to which the insurance broker or agent is contractually bound, does not prevent the service provided by the latter from being exempt from VAT under Article 135(1)(a) of the VATD.¹⁴⁴²

Share-underwriting guarantee services (which generally refers to a situation in which an underwriter guarantees, for a certain fee, to purchase or, in the case of a new issue of shares, subscribe for, the parts of the shares that cannot be sold or subscribed for on the market, the aim of such services being, therefore, to ensure that the share sale or issue will be fully purchased or subscribed for and that the issuer will receive a certain amount of capital) are unlikely to be considered insurance transactions within the meaning of Article 135(1)(a) of the VATD, since no *a priori* assumption of a final loss can be attributed to such a situation.¹⁴⁴³

¹⁴⁴¹ In November 2007, the European Commission adopted proposals to modernize the VAT regime for insurance and financial services (see XVII.1.2.b.(3)). The proposals include amending the exemption to cover “intermediation,” defined as “the supply of services rendered to, and remunerated by, a contractual party as a distinct act of mediation in relation to the insurance (...) transaction (...) by a third party intermediary.” On the conditions for qualifying as an insurance broker or agent for purposes of the exemption, see Case C-40/15, *Aspiro*.

¹⁴⁴² Case C-124/07, *J.C.M. Beheer BV v. Staatssecretaris van Financiën*.

A service whereby an operator that is independent of second-hand motor-vehicle dealers provides, for a set period and in return for payment of a predetermined sum, a warranty covering the costs of repairing the motor vehicles in the event of mechanical breakdowns covered by the warranty constitutes an insurance transaction.¹⁴⁴⁴

(2) Financial Transactions

The following financial supplies are exempt under Article 135(1)(b) to (g) of the VATD:

(a) Granting and Negotiation of Credit

The expression “the granting and the negotiation of credit”¹⁴⁴⁵ does not refer solely to loans and credit granted by banking and financial institutions. Accordingly, deferred payment of the purchase price of goods, in return for the payment of interest, may be regarded as a grant of credit, which constitutes an exempt transaction under Article 135(1)(b), provided the payment of interest constitutes not part of the consideration obtained for the supply of goods or services, but consideration for the granting of that credit.¹⁴⁴⁶

The provision of fuel cards by a parent company to its subsidiaries, allowing all the transactions carried out by means of the fuel cards to be centralized by the parent company, which receives invoices from the fuel suppliers that establish, in particular, the purchase of fuel with VAT and which, subsequently, at the end of each month, passes on the costs of the fuel made available for purposes of the supply of the vehicle transportation services, together with a surcharge of 2%, to the subsidiaries, constitutes a genuine financial transaction that is akin, more specifically, to the granting of credit for purposes of Article 135(1)(b) of the VATD.¹⁴⁴⁷

In contrast, in *Digital Charging Services*,¹⁴⁴⁸ the CJEU ruled that a card issuer that facilitates charging sessions for electric vehicles should be deemed to act as a commissionaire for the charging sessions (leaving open the question whether the card issuer acts as a commissionaire of the operator or of the driver) — the card issuer is deemed to purchase the electricity from the operator and to resell that electricity to the driver, allowing the card issuer to recover the input VAT on the purchase of the charging sessions from the tax administration. According to the Court, electric vehicle charging cards differ from fuel cards in that fuel cards involve advance payments whereby the actual use is settled and invoiced at a later date. There is no such credit mechanism with electric vehicle charging cards and, thus, no granting of credit is involved in that case.

In *Szef Krajowej Administracji Skarbowej*,¹⁴⁴⁹ relating to the VAT treatment of sub-participation agreements that allow a bank or lender to transfer its risk on an underlying loan to a third party and, more specifically, to the services provided by

¹⁴⁴³ See Opinion of Advocate General Jääskinen in Case C-540/09, *Skandinaviska Enskilda Banken*.

¹⁴⁴⁴ Case C-584/13, *Mapfre Asistencia and Mapfre Warranty SpA*.

¹⁴⁴⁵ VATD, Article 135(1)(b), first limb.

¹⁴⁴⁶ Case C-281/91, *Muys' en De Winter's Bouw- en Aannemingsbedrijf*, Case C-153/17, *Volkswagen Financial Services*.

¹⁴⁴⁷ Case C-235/18, *Vega International Car Transport and Logistic*.

¹⁴⁴⁸ Case C-60/23, *Digital Charging Solutions*.

¹⁴⁴⁹ Case C-250/21, *Szef Krajowej Administracji Skarbowej*.

a sub-participant under a sub-participation contract, consisting of the provision of a financial contribution to the initiator in exchange for the payment of proceeds from the receivables specified in the contract, which remain in the assets of the offeror, the CJEU held that such arrangements fall within the concept of granting credit, within the meaning of Article 135(1)(b). The Court thus deviated from Advocate General Medina's Opinion, which had argued that the sub-participations constitute a risk management service that should be subject to VAT.

For the combined application of the exemptions provided for in Article 135(1)(b) and 135(1)(d) (see below) of the VATD, see Case C-801/19, *Franck*, which concerned "reverse factoring" arrangements. For the combined application of the exemptions provided for in Article 135(1)(b), on the one hand, and Article 135(1)(c) and Article 135(1)(d), see Case T-184/25, *A Oy* — in her opinion issued on February 25, 2026, Advocate General Brkan concluded that credit management services provided by the originator after it transfers its loans to a securitization vehicle are not VAT-exempt under any of those provisions.

(b) Management of Credit By the Person Granting the Credit

The management of credit by the credit provider¹⁴⁵⁰ is considered further in Guideline 955 on the VAT treatment of certain services provided in relation to syndicated loans, the EU Commission VAT Committee on April 13, 2018 agreed almost unanimously that management services provided by the credit manager (one of the syndicated banks) constitute a single supply of services for VAT purposes. In particular, the credit agent is not to be seen in such circumstances as supplying two separate services (consisting of the management of the part of the syndicated loan granted by the credit agent him or herself and the management of the granted by the other syndicated banks), given that such activities are so closely linked that they form, objectively, a single, indivisible economic supply which it would be artificial to split. The VAT Committee further almost unanimously agrees that such a supply is exempt in accordance with Article 135(1)(b) because it qualifies as the management of credit by the person granting it, given that the credit agent is one of the creditors of the loan (the syndicated banks).¹⁴⁵¹

(c) Credit Guarantees

The negotiation of, or any dealings in, credit guarantees or any other security for money and the management of credit guarantees by the person granting the credit¹⁴⁵²: in Guideline 955 on the VAT treatment of certain services provided in relation to syndicated loans, the EU Commission VAT Committee on April 13, 2018 agreed almost unanimously that where credit guarantees have been provided with respect to a syndicated loan, and such guarantees are being managed as a whole by only one of the syndicated banks (the "guarantees agent") in exchange for consideration paid by the borrower, the service consisting of the management of the credit guarantees constitutes

a single supply for VAT purposes. Such a supply is exempt in accordance with Article 135(1)(c) of the VATD because it qualifies as the management of credit guarantees by the person granting the credit, given that the guarantees agent is one of the loan creditors (the syndicated banks).¹⁴⁵³

A transfer for consideration, by a company established in one Member State, to an insurance company established in a third State, of a portfolio of life reinsurance contracts, with the consequence that the transferee company assumes, with the consent of the insured persons, all the rights and obligations resulting from those contracts, does not constitute a transaction exempt under Article 135(1)(c) of the VATD.¹⁴⁵⁴

(d) General Banking and Payment Transaction

Transactions, including negotiation, concerning deposit and current accounts, payments, transfers, debts, checks and other negotiable instruments, excluding debt collection¹⁴⁵⁵: in *Hedqvist*,¹⁴⁵⁶ the CJEU held that "bitcoins," as a direct (contractual) means of payment, cannot be regarded as a "current account or deposit account, a payment or a transfer," or as "debt, checks and other negotiable instruments" referred to in Article 135(1)(d). The transactions targeted by this paragraph concern services or instruments that operate as a way of transferring money without actually involving money itself. The exchange transaction at issue, where bitcoins were exchanged for actual money, could therefore not fall within the scope of Article 135(1)(d).

In *National Exhibition Centre*,¹⁴⁵⁷ the CJEU decided that exemption is not available with respect to a service described as the "processing of payment by debit or credit card" carried out by a taxable person, the provider of that service, where an individual buys, via that provider, a ticket for a show or other event that the provider sells in the name and on behalf of another entity that the individual pays for by debit or credit card. The same applies, *mutatis mutandis*, to a "card handling" service supplied by a taxable person, the provider of that service, where an individual purchases, via that service provider, a cinema ticket that the service provider sells for and on behalf of another entity, and that the individual pays for by debit card or credit card.¹⁴⁵⁸ In *Cardpoint GmbH*,¹⁴⁵⁹ the CJEU ruled that services provided to a bank that operates ATMs consisting of making and keeping the ATMs ready for use, supplying them, installing hardware and software to read bank card data, sending an approval request for withdrawing cash to the bank that issued the bank card used for the withdrawal, providing the requested cash and registering withdrawal transactions are not transactions exempt from VAT on payments such as those referred to in Article 135(1)(d).

¹⁴⁵³ VAT Committee Guideline 955: https://taxation-customs.ec.europa.eu/system/files/2023-10/guidelines-vat-committee-meetings_en.pdf.

¹⁴⁵⁴ Case C-248/08, *Swiss Re Germany Holding*.

¹⁴⁵⁵ VATD, Article 135(1)(d).

¹⁴⁵⁶ Case C-264/14, *Hedqvist*.

¹⁴⁵⁷ Case C-130/15, *National Exhibition Centre*.

¹⁴⁵⁸ Case C-607/14, *Bookit*. See also Case C-15/17, *DPAS Limited*, in which the CJEU considered dental plan payment administrative services not to be exempt under VATD, Art. 135(1)(d), as that provision only applies to transactions that have the effect of making the legal and financial changes characteristic of transfers of money.

¹⁴⁵⁹ Case C-42/18, *Cardpoint GmbH*.

¹⁴⁵⁰ VATD, Article 135(1)(b), second limb.

¹⁴⁵¹ VAT Committee Guideline 955: https://taxation-customs.ec.europa.eu/system/files/2023-10/guidelines-vat-committee-meetings_en.pdf.

¹⁴⁵² VATD, Article 135(1)(c).

At issue in *Kosmiro*¹⁴⁶⁰ is a factoring taking the form of a sale of debts, by which the factor purchases from a client a number of debts that are invoiced but not yet due, while assuming the risk of default by that client's debtor (true (nonrecourse) factoring). Under the factoring agreement, a commission was charged by the factor to the client, consisting of a percentage of each invoiced debt covered by the agreement (that percentage being higher the longer the invoice payment period and the lower the rating of the debts concerned) as well as a fixed arrangement fee for setting up and activating the factoring process.

In the opinion of Advocate General Rantos both the factoring commission and the arrangement fee must be regarded as constituting the consideration for the provision of services falling within the scope of the VATD. The Advocate General adds that a factoring activity taking the form of a sale of debts, such as that at issue, or factoring taking the form of financing guaranteed by invoices, by which the factor grants credit to a customer in such a way that the invoiced debts of that client are used as collateral for the financing granted by the factor (quasi factoring), constitute a single and composite supply relating to "debt collection", which is subject to VAT in accordance with the exception to the VAT exemption laid down in Article 135(1)(d) of the VATD.

According to the Advocate General, that exception is unconditional and sufficiently precise to be capable of having direct effect, so that it may be relied on before a national court to contest the application of a rule of national law contrary to it. The Advocate General's opinion builds on the CJEU rulings in cases C-305/01, *MKG*, and C-175/09, *Axa UK*, where the Court held that the term "debt collection" within the meaning of Article 135(1)(d) of the VATD must be interpreted as encompassing all forms of factoring (covering both "true factoring" and "quasi-factoring"), given that, by its objective nature, the essential purpose of factoring is the recovery and collection of debts owed by a third party.

In its ruling issued on October 23, 2025, the CJEU fully upheld the Advocate General's opinion.

(e) Currency Services

Transactions, including negotiation, concerning currency, bank notes and coins used as legal tender, with the exception of collectors' items, i.e., gold, silver or other metal coins or bank notes not normally used as legal tender and coins of numismatic interest¹⁴⁶¹: in the CJEU's view, this exemption applies to financial transactions involving both traditional and non-traditional currencies.

To interpret the exemption provision as including only transactions involving traditional currencies would go against the context and aims of Article 135(1)(e), as transactions involving non-traditional currencies that have been accepted by the parties to the transactions are also financial transactions. Since a "bitcoin" exchange has no other purpose than to be a means of payment, it should thus also be considered to fall within the scope of the exemption provided for in Article 135(1)(e).¹⁴⁶²

¹⁴⁶⁰ Case C-232/24, *Kosmiro*.

¹⁴⁶¹ VATD, Article 135(1)(e).

The decision has the effect of obliging all Member States to regard the exchange of legal tender currencies for virtual currencies with bi-directional flow as VAT-exempt transactions, even States that have not yet expressed their position. A potential downside of the CJEU's ruling is that service providers performing virtual currency exchange services may face input VAT recovery restrictions.

In the same vein, in *Žaidimų valiuta*,¹⁴⁶³ the Court ruled that the exchange of virtual currency used exclusively within an online video game does not qualify for the VAT exemption for transactions concerning currency under Article 135(1)(e) of the VATD. As the virtual currency cannot be used outside the game and forms part of an electronic service provided within the game environment, transactions involving its exchange for real currency are subject to VAT under the general rules.

(f) Share Transactions

Transactions in, including negotiation but not management or safekeeping of, shares, interests in companies or associations, debentures and other securities, excluding documents establishing title to goods, and rights or securities referred to in Article 15(2)¹⁴⁶⁴ ¹⁴⁶⁵: "bitcoin" exchange transactions do not fall within the scope of the exemptions provided for in Article 135(1)(f), as it is commonly accepted that the bitcoin virtual currency is neither a security conferring a property right nor a security of a comparable nature.¹⁴⁶⁶

*CSC*¹⁴⁶⁷ concerned the outsourcing of "call center activities" by financial institutions. The question was raised as to whether such activities qualified as "negotiation in securities" within the meaning of Article 135(1)(f). According to the CJEU, "transactions in securities" means transactions liable to create, alter or extinguish parties' rights and obligations with respect to securities and, hence, "negotiation in securities" does not cover services limited to providing information about a financial product and, as the case may be, receiving and processing applications for subscription to the relevant securities, without issuing them. In contrast, negotiation is an activity whose purpose is to do all that is necessary for two parties to enter into a contract, without the negotiator having any interest of his or her own in the terms of the contract. Negotiation may, among other things, consist in pointing out suitable opportunities for concluding such a contract, making contact with another party, or negotiating, in the name and on behalf of a client, the details of the payments to be made by either side. Hence, the exemption does not apply where a service provider only provides information about the financial products at issue.

Further guidance of the CJEU reveals that the concept of "negotiation" covers an activity of an intermediary paid for supplying a service to one of the parties to a contract for financial transactions involving securities, the service consisting in arranging for the seller and the buyer to sign the contract in

¹⁴⁶² Case C-264/14, *Hedqvist*.

¹⁴⁶³ Case C-472/24, *Žaidimų valiuta*.

¹⁴⁶⁴ "Rights or securities referred to in Article 15(2)" are shares or interests equivalent to shares giving the holder thereof *de jure* or *de facto* rights of ownership or possession over immovable property or part of such property (VATD, Art. 15(2)(c)).

¹⁴⁶⁵ VATD, Article 135(1)(f).

¹⁴⁶⁶ Case C-264/14, *Hedqvist*.

¹⁴⁶⁷ Case C-235/00, *CSC*.

question, without the intermediary itself signing the contract, and, in any event, without having any interest in the content of the contract.¹⁴⁶⁸ However, the sale of a discount card does not constitute a transaction concerning “other securities” or “other negotiable instruments.”¹⁴⁶⁹

(g) *Special Investment Funds*

Management of special investment funds as defined by Member States:¹⁴⁷⁰ a considerable amount of case law has emerged on the concept and scope of “special investment funds” and the “management of special investment funds” referred to in Article 135(1)(g).

As regards the concept of a “special investment fund,” the CJEU has consistently held that one of the characteristics required for an entity to be regarded as displaying features comparable to a UCITS and therefore as a special investment fund that may benefit from the VAT exemption provided for under Article 135(1)(g) of the VATD is that the participants in the fund are entitled to the profits or bear the risk linked to the management of the fund. In other words, it is a requirement that the members bear the investment risk.¹⁴⁷¹ Members of a pension scheme do not bear the risk arising from the management of the investment fund in which the assets of the scheme are pooled where the pension received by an employee does not at all depend on the value of the scheme’s assets and the performance of the investments made by the scheme’s managers, but is defined in advance based on the employee’s length of service with the employer and the amount of the employee’s salary. This contrasts with the return that can be hoped for by persons who purchase units in a collective investment undertaking, which depends on the performance of the investments made by the fund’s managers over the period for which those persons hold the units.¹⁴⁷²

As regards the concept of the “management of special investment funds,” in *Abbey National*¹⁴⁷³ the CJEU applied the “distinct whole” criterion developed in *SDC*¹⁴⁷⁴ and held that

the concept covers the services performed by a third-party manager with respect to the administrative management of the funds if, viewed broadly, the services form a distinct whole and are specific to and essential to the management of those funds.¹⁴⁷⁵ According to the Court, the application of this criterion would exclude from the scope of the provision “mere material or technical supplies, such as making available a system of information technology.”

While it was believed that the case law referred to above had brought at least some clarity to the interpretation of the VAT exemption for the “management of special investments funds,” a further layer of complexity was arguably (re-)added by the CJEU’s decision of July 2, 2020 in *Blackrock Investment Management (UK)*.¹⁴⁷⁶ The case concerned the provision to portfolio managers of market analysis and monitoring, regulatory compliance and execution services through an online platform called Aladdin (“Aladdin services”) to assist them in making and implementing investment decisions. The portfolio managers used the Aladdin services to assist them in managing a number of funds. These funds included some special investment funds, but the majority were not special investment funds. BlackRock did not dispute the fact that the supply of services in question was a single supply but argued that it should nonetheless be entitled to apportion the platform fees and to account for VAT only on the part of the fees that related to BlackRock’s use of the platform to manage non-special investment funds. It proposed to apportion the fees in accordance with the value of assets under management in the special investment and non-special investment funds for the management of which the platform was used.¹⁴⁷⁷

Following the opinion rendered by Advocate General Pikamäe, the CJEU rejected this argument, holding that whether a particular service falls within the VAT exemption for the management of special investment funds must be determined by reference to the nature of the service, rather than the use to which the service is put (although it seems that the use to which a service is put may shed some light on the na-

¹⁴⁶⁸ Case C-165/16, *Kerr*.

¹⁴⁶⁹ Case C-461/12, *Granton*.

¹⁴⁷⁰ Article 135(1)(g).

¹⁴⁷¹ Case C-424/11, *Wheels*; Case C-464/12, *ATP PensionService*; C 464/12, Case C-595/13, *Fiscale Eenheid X*; Joined Cases C-639/22 to 644/22, *Inspecteur van de Belastingdienst Utrecht and Others*.

¹⁴⁷² Case C-424/11, *Wheels Common Investment Fund Trustees and Others*; Joined Cases C-639/22 to 644/22, *Inspecteur van de Belastingdienst Utrecht and Others*.

¹⁴⁷³ Case C-169/04, *Abbey National*.

¹⁴⁷⁴ Beginning with the seminal case, Case 295, *SDC*, the CJEU has suggested two main criteria for determining the scope of the exemptions applicable to financial supplies: (i) the identity of the person effecting the transactions is irrelevant in determining the transactions exempt under those provisions, meaning that such transactions are defined in terms of their nature; and (ii) financial-related supplies fall within the scope of the exemptions where they form a distinct whole, fulfilling in effect the specific essential functions of the services described (the “distinct whole” criterion): where the services being outsourced or sub-contracted form a “distinct whole,” they will be regarded as exempt; however, where the outsourcing or sub-contracting is restricted to preliminary and technical activities, the exemptions will not apply. This reasoning holds true, at least, for financial-related supplies falling within the scope of VATD, Art. 135(1)(b), (d), (f) and (g). However, questions remain as to whether the “distinct whole” criterion may be applied to the financial supplies listed in VATD, Art. 135(1)(c) and (e). See also Case C-453/05, *Volker Ludwig*, in which the Court seemingly introduced a new criterion, i.e. financial-related activities will be deemed to be exempt where they are deemed to be ancil-

lary to the principal exempt activity — in other words, an outsourced activity will be deemed to be exempt where it constitutes an activity ancillary to an exempt financial supply. According to the decision, canvassing for new financial services clients seems to fall within that concept; however, beyond such activities, the situation remains unclear.

¹⁴⁷⁵ According to the CJEU, the VAT exemption covers transactions that are specific to the business of undertakings for collective investment. Along with portfolio management, this includes the following (all taken from the heading “Administration” in UCITS Directive (85/611/EEC), Annex II): legal and fund management accounting services; customer enquiries; valuation and pricing (including for tax returns); regulatory compliance monitoring; the maintenance of unit-holder registers; the distribution of income; unit issues and redemptions; contract settlements (including certificate dispatch); and record keeping. On the other hand, in the same case, the CJEU also held that services corresponding to the functions of a depositary, such as those set out in UCITS Directive, Arts. 7(1) and (3) and 14(1) and (3) are not covered by the exemption.

¹⁴⁷⁶ Case C-231/19, *Blackrock Investment Management (UK)*.

¹⁴⁷⁷ Conceptually, in the author’s view, the result sought by BlackRock, whereby the platform fees are apportioned so that the element relating to the management of special investment funds is exempt, and the element relating to the management of non-special investment funds is taxable, appears to be commercially sensible as a way of achieving the purpose of the exemption, i.e., to facilitate collective investment through certain investment vehicles (i.e., special investment funds) by removing VAT from the cost of managing those vehicles.

ture of the service). Hence, the nature (i.e., special investment fund or non-special investment fund) of the majority fund for the management of which the Aladdin services are used cannot be determinative of the VAT status of these services as this “could lead to the benefit of the exemption for the management of special investment funds being accorded to other funds (...) contrary to the strict nature of the interpretation given to the exemption.”

The Court added, referring to the judgments in *Abbey National* and *GfBk*, referred to above, that to be VAT-exempt, “the services provided by a third-party manager must, viewed broadly, form a distinct whole fulfilling in effect the specific, essential functions of the management of special investment funds.”¹⁴⁷⁸ Because, in the case at hand, the software services could be used in the same way for the management of special investment funds and non-special investment funds, in the Court’s view, this criterion was not satisfied. Finally, the Court held that the consideration for the Aladdin services could not be apportioned between a VAT exempt and a VAT-able element based on the nature of the funds for the management of which the services were used as “[t]he wording of [the exemption] does not (...) permit the tax treatment of a single supply to be dissociated according to its uses.”¹⁴⁷⁹

In *JP Morgan Fleming Claverhouse Investment Trust Plc*,¹⁴⁸⁰ the CJEU was questioned on the interpretation of the VAT exemption for the “management of special investments funds” from the perspective of the type of investment fund whose management is exempt. More specifically, the question was raised as to whether the United Kingdom was entitled to deny a VAT exemption with respect to the management of investment trust companies (closed-ended funds with their own legal personality) while allowing it with respect to authorized unit trusts and open-ended investment companies. In accordance with the principle of fiscal neutrality, which requires that all similar, and therefore competing, special investment funds be treated equally as regards the levying of VAT, the Court concluded that the concept of “special investment funds” is capable of including closed-ended investment funds, such as investment trust companies. In *GfBk*,¹⁴⁸¹ the CJEU held that fund investment advisory services that are intrinsically connected to the activity characteristic of an investment management company (managing a contractual investment fund) and are specific to, and essential for, the fund, are eligible to benefit from the VAT exemption for fund management services, whether delegated to a third party or not. The fact that the (third-party) investment adviser makes no decisions for the investment fund is irrelevant because the supplies are “specific and essential” to the functions of the fund.¹⁴⁸²

¹⁴⁷⁸ See also Joined Cases C-58/20, *K* and C-59/20, *DBKAG*.

¹⁴⁷⁹ The CJEU’s decision to allow apportionment in Case C-274/15, *Commission v. Luxembourg* was said to be irrelevant because the cost-sharing exemption at issue in that case provided for differing tax treatment depending on the use made of the supply.

¹⁴⁸⁰ Case C-363/05, *JP Morgan Fleming Claverhouse Investment Trust plc (Claverhouse) v. HMRC*.

¹⁴⁸¹ Case C-275/11, *GfBk*.

¹⁴⁸² The CJEU added that the fact that advisory and information services are not listed in UCITS Directive, Annex II under the heading “management” of an investment fund does not preclude their inclusion in the “management of a special investment fund,” since Annex II itself states that the list is “not exhaustive.”

In *Wheels*,¹⁴⁸³ the question was raised as to whether the term “special investment funds” is capable of including either a defined benefit occupational pension scheme, or a common investment fund in which the assets of several such pension schemes are pooled for investment purposes, or both. The CJEU concluded that, where the members of the pension scheme do not bear the risk arising from the management of the fund and the employer’s contributions are a means by which it complies with its legal obligations to its employees, an investment fund pooling the assets of a pension scheme is not a “special investment fund” for these purposes. Accordingly, the management of such a fund is not exempt from VAT. Although the decision is less clear in relation to the position of defined benefit pension schemes themselves, by implication, the same analysis would seem to apply.

In *Fiscale Eenheid X*,¹⁴⁸⁴ the Court confirmed that investment funds may qualify as special investment funds provided, however, they are subject to specific State supervision.¹⁴⁸⁵ Funds that invest solely in real estate (and other non-UCITS funds) also qualify if they meet that same condition. In addition to UCITS regulations, the CJEU’s decision suggests that regulatory supervision of Alternative Investment Fund Managers (AIFMs) based on the AIFM Directive qualifies as specific State supervision. As a result, the supply of investment management services to funds meeting the specific State supervision requirement is exempt from VAT. However, the exemption does not extend to the actual day-to-day management of real estate. Thus, such property management services remain subject to VAT and the property manager continues to be entitled to recover VAT incurred in providing such services, including for example, on building services purchased to develop the real estate. The fund may recover such VAT charged to it on day-to-day activities provided its letting activity is subject to VAT.

In line with *Blackrock* and *Fiscale Eenheid X*, the CJEU held, in *DBKAG & K*,¹⁴⁸⁶ that both the right to use software and specific administrative services may fall within the exemption provided for in Article 135(1)(g) of the VATD, provided such services are “specific to and essential for the management of special investment funds” and “intrinsically connected to the activity characteristic of a management company.” Interestingly, both cases concern independent services that may be outsourced, implying that the criteria for the services being within the scope of the exemption are exclusively objective (what kind of services are being provided), regardless of what entity provides the services.

(3) Insurance and Financial Transactions — Need for Legislative Review

Determining the actual scope of the exemptions applicable to insurance and financial supplies has proven to be problem-

¹⁴⁸³ Case C-424/11, *Wheels*.

¹⁴⁸⁴ Case C-595/13, *Fiscale Eenheid X*.

¹⁴⁸⁵ According to the CJEU, specific State supervision means that there must be common basis rules for authorization, structure, activities and the duty to publish certain information. Previous CJEU rulings suggest that pension fund supervision and stock exchange regulations applicable to listed investment funds also qualify as specific State supervision, see, e.g., Case C-363/05, *JP Morgan Fleming Claverhouse Investment Trust plc (Claverhouse) v. HMRC*, and Case C-464/12, *ATP*.

¹⁴⁸⁶ Joined Cases C-58/20 and C-59/20, *K & DBKAG*.

atic. Complexity has been added by the development, over the last few decades, of new forms of financial products, as well as the emergence of new supply structures that make use of, *inter alia*, outsourcing, sub-contracting and pooling techniques, as well as the rise of the internet as a medium for B2B and B2C transactions, raising the question of whether these new products and new supply structures fall within the scope of the exemptions. As a result, Member States' application of VAT in this area is far from uniform.

In this context, it comes as no surprise that the growing level of case law emerging from the CJEU on the scope of the exemptions applicable to insurance and financial supplies is complex and highly fact-based. Undoubtedly, the CJEU is struggling to choose criteria for determining the scope of the exemptions. More specifically, it is felt that the current regime gives rise to definitional and interpretational problems, creates difficulties in calculating the portion of deductible VAT, constitutes an incentive for engaging in aggressive tax planning, and — perhaps even more importantly — raises questions as to its compatibility with the principle of VAT as a tax on consumption, and the principles of fiscal neutrality and equal treatment. All these factors have heightened the level of legal uncertainty that currently surrounds the VAT treatment of insurance and financial transactions. Not unexpectedly there is growing consensus on the need to proceed to a fundamental legislative review in this area.

The legislative review process¹⁴⁸⁷ started with an analytical phase (December 2004–December 2005), followed by a second phase (January 2006–December 2006) during which the analytic findings of the first phase (see working document 1802/062) were discussed with Member States and economic operators (open consultation) and compared with a study commissioned with an international tax consultant on the impact of VAT in the decision making of economic operators. A 2006 Commission consultation paper identified four possible options for the amendment of the VAT Directive provisions on insurance and financial services that would satisfy the Commission's essential criteria, namely that they should be both technically feasible and have the capacity to address, at least partially, the problem of nondeductible input VAT: (i) zero-rating the supply of insurance and financial services to other taxable persons; (ii) extending the scope of exemptions to services supplied by other taxable persons to insurance and financial services suppliers; (iii) a uniform limited input credit option, based on a fixed percentage for a designated list of acquired services; and (iv) allowing economic operators to opt to tax their supplies and financial services on B2B transactions. Two further options also under consideration are: (i) the creation of cross-border VAT bodies (groups, cost-sharing arrangements or other structures), within which transactions carried out would be deemed to be outside the scope of VAT; and (ii) a re-definition of exempt insurance and financial services, through the modernization of the current VATD provisions. Interestingly, the option for full taxation was excluded from the remit of the consultation paper.

¹⁴⁸⁷ For a comprehensive overview of this process (including full references to the working papers and the 2006 consultation paper), see: http://ec.europa.eu/taxation_customs/resources/documents/common/publications/services_papers/other_papers/background_paper_2414_08_en.pdf.

In November 2007, the European Commission presented two legislative proposals with a view to amending the EU VAT treatment of financial (and insurance) services.¹⁴⁸⁸ In the words of the Commission, the objectives pursued by these proposals were threefold: (i) to increase legal certainty for all concerned, from the business sector to national tax administrations, and thereby reduce their administrative burden in correctly applying the VAT provisions to such services; (ii) to ensure a more consistent application of the tax and deliver a level playing field in the internal market, at least as far as VAT is concerned; and (iii) to allow businesses to manage better the impact of non-deductible VAT on their activities. The 2007 proposals included three measures (referred to as the “three pillars”) designed to achieve these objectives, namely: (i) clarifying the rules governing the exemption for financial supplies, and in particular redefining the financial services qualifying for exemption; (ii) introducing a cost-sharing group, allowing economic operators to pool investments and re-distribute the costs of these investments to the members of the group, exempt from VAT; and (iii) introducing a “compulsory option” to tax, i.e., compulsory for Member States, but optional for financial institutions.¹⁴⁸⁹

And then there was a deafening silence for years.

In what seems to be a possible relaunch, on October 10, 2020, the Commission published a combined evaluation roadmap and inception impact assessment on the proposed amendments to the VAT rules for financial and insurance services. This was followed on February 8, 2021 by the initiation of a (second) public consultation phase that ran until May 3, 2021 and was designed to gather feedback to be taken into account in the further development of proposals.

While the roadmap suggested that the Commission would publish an impact assessment in the third quarter of 2021 and put forward a proposal for a Directive based on the feedback and impact assessment in the fourth quarter of 2021, these deadlines no longer seem to be accurate.

Rather, on September 9, 2021, the Commission released a Factual Summary Report — Public consultation “VAT rules for financial and insurance services today and tomorrow,”¹⁴⁹⁰ in which it announced a later “synopsis report,” in which it was to reach a conclusion on all the consultations engaged in and feedback received during the project. In particular, according to the Commission, the synopsis report would contain a detailed analysis of all contributions to the public consultation

¹⁴⁸⁸ Proposal for a Council Directive Amending Directive 2006/112/EC on the Common System of Value Added Tax, as regards the treatment of insurance and financial services, COM (2007) 747 final, November 28, 2007; and Proposal for a Council Regulation Laying Down Implementing Measures for Directive 2006/112/EC on the common system of value added tax, as regards the treatment of insurance and financial services, COM (2007) 746 final, November 28, 2007 (expanding the definitions of exempt services). A Corrigendum of February 20, 2008 replaced COM (2007) 747 final with COM (2007) final/2 making a change in the paragraph on the subsidiarity principle in the Explanatory Memorandum.

¹⁴⁸⁹ As opposed to the current regime, under which Member States “may allow” taxable persons a right to opt for taxation with respect to the financial transactions referred to in VATD, Art. 135(1)(b) to (g) (VATD, Art. 137(1)(a)).

¹⁴⁹⁰ https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12671-Review-of-the-VAT-rules-for-financial-and-insurance-services/public-consultation_en.

(including responses to open questions and position papers uploaded in addition to the questionnaire). It would also incorporate the feedback provided at the start of the project on the roadmap of the combined evaluation and impact assessment — and a review of other position papers submitted by stakeholders to the Commission. Finally, it would reflect findings from regular meetings with stakeholders and Member States alike. The analysis of all these consultations was expected eventually to feed into the preparation of an Impact Assessment presenting the overall analysis, findings and options for the review of VAT rules for financial and insurance services. The synopsis report was to be added as a specific annex on stakeholder consultations to that Impact Assessment. Expectations were that the Commission would eventually propose two policy options: (i) remove the exemption entirely, which could simplify VAT rules for the financial and insurance sector and eliminate the costs of irrecoverable input VAT; or (ii) retain the exemption but narrow its scope to cover only some service types, such as those that are fee-based rather than interest-based.

These repeated Commission initiatives, including its 2007 proposals and the 2020 inception impact assessment, did not result in a reform of the VAT exemption for the financial sector. Also, the Commission's intention to publish amendments to the VATD in early 2023 was stalled, leaving the reform still pending.

The latest development is the European Parliament Committee on Economic and Monetary Affairs draft report of February 4, 2026 on a coherent tax framework for the EU's financial sector (2024/2117(INI)),¹⁴⁹¹ stating that the VAT exemption for financial services, introduced nearly 50 years ago as a temporary technical measure, is misaligned with today's economic and technological realities. The draft report adds that rather than promoting a level playing field and Europe's financial competitiveness, the exemption creates hidden costs, distorts business models, discourages outsourcing and innovation, and places some firms — particularly fintech and digital financial services — at a competitive disadvantage. MEPs have submitted more than 200 amendments to the draft report.¹⁴⁹² A Committee vote on the draft report was scheduled for May 5, 2026 and a plenary vote is expected in June 2026.

(4) *Supply of Postage Stamps, Fiscal Stamps and Other Similar Stamps*

The supply at face value of postage stamps valid for use for postal services within the Member States' respective territory is exempt from VAT.¹⁴⁹³

(5) *Betting, Lotteries and Other Forms of Gambling*

Article 135(1)(i) of the VATD exempts betting, lotteries and other forms of gambling, subject to the conditions and limitations laid down by each Member State.

Games that are not covered by this provision, such as pin-ball machines and all kinds of internet games, are subject to VAT, which is payable by EU providers in their Member State of establishment.

Article 135(1)(i) of the VATD precludes national legislation that provides that the operation of all games of chance and gaming machines is exempt from VAT where it is carried out in licensed public casinos, while the operation of the same activity by traders other than those running casinos does not enjoy that exemption.¹⁴⁹⁴ This holds true even if the game of chance concerned is operated unlawfully.¹⁴⁹⁵

The qualification “subject to the conditions and limitations laid down by each Member State” must be interpreted as meaning that the exercise of the discretionary power of the Member States to fix conditions for, and limitations to, the VAT exemption provided for under that provision allows those States to exempt from VAT only certain forms of betting and gaming.¹⁴⁹⁶ Thus, Member States are permitted to determine which betting and gaming activities are exempt for VAT purposes, but this discretion is fettered by the principle of fiscal neutrality in that similar forms of gambling that may be regarded as in competition with one another cannot be treated differently. In other words, Member States are not precluded by the principles of fiscal neutrality from applying a different VAT treatment to different gambling and betting supplies to the extent those different supplies (whether online or otherwise) fulfil the different needs of consumers.¹⁴⁹⁷

(6) *Certain Supplies and Leasing of Immovable Property, Buildings and Land*

(a) *General*

VAT exemptions with respect to immovable property (carrying a right to deduct) apply to: (i) supplies of buildings and land (Articles 135(1)(j) and (k) of the VATD); and (ii) the leasing and letting of immovable property (Article 135(1)(l) of the VATD).

Although the VATD uses the term “immovable property,” it does not define it. However, it can be derived from the VATD that certain items qualify as immovable property. In general, land and structures fixed to or in the ground qualify as immovable property in every Member State.

In *Maierhofer*,¹⁴⁹⁸ the CJEU reached the conclusion that it is not necessary for a structure to be inseparably fixed to or in the ground for it to be “immovable property.” It is sufficient for the structure to be fixed in such a way that it cannot be easily moved or easily dismantled. The case concerned single-story and two-story buildings constructed from prefabricated compo-

¹⁴⁹⁴ Joined Cases C-453/02, *Edith Linneweber v. Finanzamt Gladbeck* and C-462/02, *Savvas Akritidis v. Finanzamt Herne-West*.

¹⁴⁹⁵ C-283/95, *Karlheinz Fischer v. Finanzamt Donaueschingen*.

¹⁴⁹⁶ Case C-58/09 *Leo-Libera*; see, in the same vein, Case C-440/12, *Metropol Spielstätten*, in which the CJEU also repeated that EU law (in particular, VATD, Art. 401) does not, in principle, prevent a Member State from levying, cumulatively on a particular transaction, VAT and a special tax on betting and gambling, provided the special tax cannot be characterized as a tax on turnover (see also Case 73/85 *Kerrutt*).

¹⁴⁹⁷ Joined Cases C-259/10 and C-260/10, *Rank Group*; Case C-73/23, *Chaudfontaine Loisirs*; see also, Case C-741/22, *Casino de Spa*.

¹⁴⁹⁸ Case C-3215/00, *Maierhofer*.

¹⁴⁹¹ https://www.europarl.europa.eu/doceo/document/ECON-PR-779360_EN.pdf. Incidentally, the draft report also suggests to reactivate the FTT initiative despite the fact that it was tabled in the 2026 EU Commission Work Program as “withdrawn” (see, IX.B.1., above).

¹⁴⁹² See https://www.europarl.europa.eu/doceo/document/ECON-AM-786665_EN.pdf.

¹⁴⁹³ VATD, Art. 135(1)(h).

nents that stood on concrete bases erected on concrete foundations sunk into the ground. The wall panels were secured to the foundations by bolts and the roof was tiled. The buildings could be dismantled on the expiry of the lease for subsequent re-use but only by having recourse to eight persons over 10 days. The CJEU found that the buildings were “immovable.”

(b) *Supplies of Buildings and Land*

The supply of a building or parts of a building and of the land on which the building stands (other than occasional supply, before the first occupation referred to in Article 12(1)(a) of the VATD) and the supply of land that has not been built on (other than the supply of building land referred to in Article 12(1)(b) of the VATD) are exempt from VAT.¹⁴⁹⁹

In response to a Belgian referral on the condition of the first use of a building, the CJEU held that the exemption in VATD, Art. 135(1)(j), read in conjunction with VATD, Art. 12(1) and (2), must be interpreted as meaning that the exemption provided for by the first provision for the supply of a building or part of a building, and of the land on which the building stands, other than a building supplied before its first occupation, also applies to the supply of a building that was first occupied before its conversion, even if the Member State concerned has not laid down, in its national law, the detailed rules for applying the criterion of first occupation to conversions of buildings, as the second of those provisions authorizes it to do so (Case C-239/22, *Belgian State and Promo 54*). The supply of land on which, at the time of that supply, only foundations for residential buildings have been laid cannot be classified as a “building” or “part of a building”, but should instead be classified as a supply of “building land” — the criterion of “first occupation” is important, as purely residential building foundations cannot qualify for “occupation” (Case C-594/23, *Lomoco Development and Others*).

However, Member States may allow taxable persons the right to opt for taxation with respect to such supplies, in which case they are to lay down the detailed rules governing the exercise of the option and are allowed to restrict the scope of that right of option.¹⁵⁰⁰

The exemption from VAT with respect to supplies of a building or parts of a building and of the land on which the building stands covers a supply of immovable property consisting of a plot of land and an old building undergoing conversion into a new building where, at the time of supply, the old building has only undergone partial demolition work and is, at least in part, still used as such.¹⁵⁰¹

The exemption from VAT with respect to the supply of unbuilt on land does not cover the supply of land that has not been built on following the demolition of a building situated on it. This applies even where, at the time of the supply, improvement works on the land, apart from that demolition, have

not been carried out, but it is apparent from an overall assessment of the factual circumstances surrounding the transaction and prevailing at the time of supply, including the proven intention of the parties, that, at that time, the land at issue is in fact intended to be built on (a matter that is for the referring court to determine).¹⁵⁰²

(c) *Leasing and Letting of Immovable Property*

Article 135(1)(l) of the VATD exempts the leasing or letting of immovable property from VAT.

The following are excluded from the exemption: (i) the provision of accommodation, as defined in the laws of the Member States, in the hotel sector or in a sector with a similar function, including the provision of accommodation in holiday camps or on sites developed for use as camping sites; (ii) the letting of premises and sites for the parking of vehicles; (iii) the letting of permanently installed equipment and machinery; and (iv) the hiring of safes.¹⁵⁰³

In addition, Member States may allow taxable persons a right to opt for taxation with respect to the leasing or letting of immovable property; Member States are to lay down the detailed rules governing the exercise of this option and may restrict the scope of the option right.¹⁵⁰⁴

Article 135(1)(l) of the VATD neither defines “letting” nor refers to relevant definitions adopted in the legal orders of the Member States.¹⁵⁰⁵ The provision must therefore be interpreted in light of the context in which it is used, and of the objectives and scheme of the VATD, having particular regard to the underlying purpose of the exemption that it establishes.¹⁵⁰⁶ In *Maierhofer*,¹⁵⁰⁷ which concerned the VAT treatment of the supply of prefabricated buildings used as temporary housing for asylum seekers, the CJEU determined that there is a letting of immovable property where there is a supply of a prefabricated building fixed to or in the ground in such a way that it cannot be either easily dismantled or easily moved. This is the case even if the building is to be removed at the end of the lease and reused on another site.

In *Belgian State v. Temco Europe*,¹⁵⁰⁸ the CJEU pointed out that “the leasing and the letting of immovable property” involves contracts that have as their essential object the making available, in a passive manner, of premises or parts of buildings in exchange for a payment linked to the passage of time. The Court took this approach to distinguish between a transaction comprising the letting of immovable property, which is usually

¹⁵⁰² Case C-543/11, *Woningstichting Maasdriel v. Staatssecretaris van Financiën*.

¹⁵⁰³ VATD, Art. 135(2)(a)–(b). Member States may apply further exclusions to the scope of the exemption.

¹⁵⁰⁴ VATD, Art. 137(1)(d) and 137(2). No adjustment of the VAT initially deducted may be applied on the grounds that a property, for which the right to opt for taxation was exercised, is regarded as no longer being used by the taxable person for purposes of its own taxed transactions, where that property has remained unoccupied for more than two years, even though it is established that the taxable person has sought to rent it during that period (Case C-672/16, *Imofloresmira*).

¹⁵⁰⁵ See Case C-326/99, *Goed Wonen*; Case C-275/01, *Sinclair Collis*.

¹⁵⁰⁶ Case C-326/99, *Goed Wonen*.

¹⁵⁰⁷ Case C-315/00, *Maierhofer*.

¹⁵⁰⁸ Case C-284/03, *Belgian State v. Temco Europe*.

¹⁴⁹⁹ VATD, Art. 135(1)(j) and (k).

¹⁵⁰⁰ VATD, Art. 137(1)(b) and (c) and 137(2).

¹⁵⁰¹ Case C-326/11, *J.J. Komen en Zonen Beheer Heerhugowaard BV v. Staatssecretaris van Financiën*; see also Case C-461/08, *Don Bosco Onroerend Goed* and Case C-308/16, *Kozuba*. However, the fact that the parties’ sole intention is to demolish a building and construct a new building is not sufficient for a plot of land with an existing building to qualify as building land (see Case C-71/18, *KPC Herning*).

a “relatively passive activity”¹⁵⁰⁹ linked simply to the passage of time and not generating any significant added value from other activities that are either industrial or commercial in nature (such as the activities covered by the exceptions from the exemption referred to in Article 135(2)(a)–(d) of the VATD), and a transaction that has as its subject-matter something that is better understood as the provision of a service than simply the making available of property, such as the right to use a golf course,¹⁵¹⁰ the right to use a bridge in consideration of payment of a toll¹⁵¹¹ or the right to install cigarette machines in commercial premises.¹⁵¹² Arguably, the “relatively passive activity” criterion is unclear and thus a source of uncertainty.

In *MacDonald Resorts Ltd v. HMRC*,¹⁵¹³ services supplied under a timeshare scheme, under which members redeemed points previously acquired for cash, were held to fall within the exemption for the leasing or letting of immovable property. Under the scheme at issue, members of the scheme were able to acquire points by purchasing them or by exchanging their existing timeshare holiday rights for points and paying a fee. Members could then exchange their points for the right to occupy holiday accommodation for a specified period. Management charges applied and a reservation fee was payable when points were redeemed. The CJEU noted that the right to temporary use of a property under the scheme entitled a scheme member to occupy a property as if he or she were the owner and to exclude any other person from enjoyment of the property for the specified period. This satisfied the element of occupation required for the scheme to amount to the leasing or letting of immovable property.¹⁵¹⁴

In *Tellmer*,¹⁵¹⁵ the CJEU treated service charges paid by tenants to a landlord as a separate supply of services (subject to VAT) distinct from the supply of land under the lease. In *Field Fisher Waterhouse*,¹⁵¹⁶ however, in considering that obtaining the services to which a service charge relates cannot be regarded as an end in itself for an average tenant of premises, but constitutes rather a means of better enjoying the principal supply, namely the leasing of commercial premises, the CJEU seems to see a normal service charge as part of the consideration for a composite supply of land and therefore as exempt from VAT.

In contrast, the act of making available, for consideration, a football stadium under a contract reserving certain rights and prerogatives to the stadium owner and providing for the supply, by the owner, of various services (including services of maintenance, cleaning, repair and upgrading, representing 80% of the charge agreed in the contract to be payable) does not, as a gen-

eral rule, constitute the “letting of immovable property” within the meaning of Article 135(1)(l) of the VATD.¹⁵¹⁷

Computing center services where the supplier of the services makes available to its customers equipment cabinets for holding their servers and provides them with ancillary goods and services, such as electricity and various services designed to ensure the use of those servers under optimal conditions, do not constitute the letting of immovable property falling within the exemption from VAT provided for by Article 135(1)(l), where: (i) the supplier does not provide an area or space to its customers passively, guaranteeing them the right to occupy it as if they were its owners; and (ii) the equipment cabinets neither form an integral part of the building in which they are installed nor are installed there permanently.¹⁵¹⁸ The implication seems to be that the exemption might be available in instances where the service would entitle the customer to avail itself of a specific, exclusive and freely accessible server room.

3. Exemptions Carrying Right to Deduct

a. Intra-European Union Supplies of Goods

(1) General

An intra-EU supply of goods is a transaction in which goods are dispatched or transported by or on behalf of a supplier or a customer from one Member State to a destination in another Member State.

Under the wording of Article 138(1) of the VATD, Member States are to exempt the supply of goods dispatched or transported to a destination outside their respective territory but within the European Union, by or on behalf of the vendor or the person acquiring the goods, where the following conditions are fulfilled: (i) the goods are supplied to another taxable person, or to a non-taxable legal person acting as such in a Member State other than that in which the dispatch or transportation of the goods begins; and (ii) the taxable person or non-taxable legal person for which the supply is made has a VAT identification number in a Member State other than that in which the dispatch or transportation of the goods begins and has indicated this identification number to the supplier.¹⁵¹⁹

The substantive conditions for an intra-EU supply to be exempt laid down in Article 138(1) of the VATD are exhaustive.¹⁵²⁰ The exemption must be granted where the substantive

¹⁵⁰⁹ See also Case C-326/99, *Goed Wonen*, in which the CJEU held, with reference to the “relatively passive activity” criterion, that Member States may classify a usufruct right as a VAT-exempt leasing of immovable property. A further illustration of the “relatively passive activity” criterion may be found in Case C-278/18, *Sequeira Mesquita*, concerning a contract for the transfer of the use of land comprising vineyards for agricultural purposes.

¹⁵¹⁰ Case C-150/99, *Stockholm Lindöpark*.

¹⁵¹¹ Case C-358/97, *Commission v. Ireland*.

¹⁵¹² Case C-275/01, *Sinclair Collis*.

¹⁵¹³ Case C-270/09, *MacDonald Resorts Ltd v. HMRC*.

¹⁵¹⁴ See Case C-108/99, *Commissioners of HM Customs & Excise v. Cantor Fitzgerald International*; Case C-275/01, *Sinclair Collis*.

¹⁵¹⁵ Case C-207/07, *Tellmer*.

¹⁵¹⁶ Case C-392/11, *Field Fisher Waterhouse*.

¹⁵¹⁷ Case C-55/14, *Régie communale autonome du stade Luc Varenne*.

¹⁵¹⁸ Case C-215/19, *Veronsaajien oikeudenvalvontayksikkö — A Oy*.

¹⁵¹⁹ See also the discussion on chain transactions (and related case law) at XVII.E.2.b.(4).

¹⁵²⁰ Case C-492/13, *Traum*; Case C-21/16, *Euro Tyre*. See also Case C-386/16, *Toridas*, in which the CJEU makes it clear that the processing of the supplied goods does not form part of the substantive conditions laid down by VATD, Art. 138(1) — as regards a chain of two supplies, the first supply cannot be classified as an intra-EU supply since no intra-EU transport can be ascribed to it; therefore, processing of the goods, in the course of a chain of two successive supplies, carried out on the instructions of the middleman acquiring the goods and before the goods are transported to the Member State of the person finally acquiring them has no effect on the conditions for any exemption of the first supply where that processing takes place after the first supply.

conditions are satisfied, even if certain formal requirements are not met.¹⁵²¹

Article 138(1) of the VATD must be interpreted as having direct effect, so that it may be relied on by taxable persons before national courts against the State to obtain an exemption from VAT with respect to an intra-EU supply of goods.¹⁵²²

Under Article 138(1a) of the VATD, the intra-EU supply of goods exemption does not apply where the supplier has not complied with the obligation to submit a recapitulative statement (Articles 262 and 263 of the VATD) or the recapitulative statement submitted does not set out the correct information concerning this supply (Article 264 of the VATD), unless the supplier can duly justify this shortcoming to the satisfaction of the competent authorities.¹⁵²³

In addition, the exemption provided for in Article 138(1) of the VATD does not apply to: (i) the supply of goods made by taxable persons that are covered by the exemption for small enterprises (within the meaning of Articles 282 to 292 of the VATD); (ii) the supply of goods to taxable persons, or non-taxable legal persons whose intra-EU acquisitions of goods are not subject to VAT under Article 3(1) of the VATD (i.e., they are below the 10,000-euro threshold); (iii) the supply of goods subject to VAT in accordance with the margin scheme (within the meaning of Articles 312 to 325 of the VATD) or the special arrangements for sale by public auction; (iv) the supply of second-hand means of transport (as defined in Article 327(3) of the VATD) subject to VAT in accordance with the transitional arrangements for second-hand means of transport.¹⁵²⁴

Under Article 138(2) of the VATD, a Member State must also exempt the supply of:

- (i) New means of transport, dispatched or transported to a customer at a destination outside the Member State's respective territory but within the European Union, by or on behalf of the vendor or the customer, for a taxable person, a nontaxable legal person whose intra-EU acquisitions of goods are not subject to VAT under Article 3(1) of the VATD or any other non-taxable person;
- (ii) Products subject to excise duty, dispatched or transported to a customer at a destination outside the Member State's respective territory but within the European Union, by or on behalf of the vendor or the customer, for a taxable person, or a non-taxable legal person whose intra-EU acquisitions of goods other than products subject to excise duty are not subject to VAT under Article 3(1), where those products are dispatched or transported under cover of an accompanying document or to a registered or temporarily registered consignee; and
- (iii) Goods, consisting in a transfer to another Member State, i.e., a fictitious intra-EU supply, that would have qualified for exemption under Article 138(1) or Article

138(2) (a) or (b) of the VATD, if it had been made on behalf of another taxable person.

However, the exemption applicable to the supply of products subject to excise duties (Article 138(2)(b) of the VATD) does not apply to the supply of products subject to excise duty by taxable persons covered by the exemption for small enterprises. Also, the exemptions provided for in Article 138(2)(b) and (c) of the VATD do not apply to the supply of goods subject to VAT in accordance with the margin scheme (within the meaning of Articles 312 to 325 of the VATD) or the special arrangements for sales by public auction. Finally, the exemption provided for in Article 138(2)(c)) does not apply to the supply of secondhand means of transport (as defined in Article 327(3) of the VATD) subject to VAT in accordance with the transitional arrangements for secondhand means of transport.¹⁵²⁵

According to the CJEU, Article 138(2)(a) of the VATD (the intra-EU supply of new means of transport) precludes national provisions from making the benefit of the exemption for an intra-EU supply of a new means of transport subject to the requirement that the purchaser of that means of transport be established or domiciled in the Member State of destination of that means of transport. In addition, the exemption for a supply of a new means of transport cannot be denied in the Member State of supply on the sole grounds that the means of transport has been registered only temporarily in the Member State of destination. Article 138(2)(a) precludes the vendor of a new means of transport, transported by the purchaser to another Member State and registered in that latter State temporarily, from being required to pay VAT at a later stage when it has not been established that the temporary registration regime has ended and VAT has or will be paid in the Member State of destination. Finally, Article 138(2)(a), as well as the principles of legal certainty, proportionality and the protection of legitimate expectations, preclude the vendor of a new means of transport, transported by the purchaser to another Member State and registered on a temporary basis in that State, from being required to pay VAT at a later stage in the event of tax evasion by the purchaser. This does not apply where it has been established, in light of objective evidence, that the vendor knew or ought to have known that the transaction was part of a fraud committed by the purchaser and did not take all reasonable steps within its power to avoid participating in that fraud.¹⁵²⁶

(2) "Deemed Supplier" Online Platforms

Where a taxable person is deemed to have received and supplied goods in accordance with the "deemed supplier" online platform rule in Article 14a(2) of the VATD — i.e., there has been a deemed B2B supply within the European Union, see XVII.D.1.a.(2), above — the supply of those goods is exempt with the right of deduction for the underlying supplier (Articles 136a and 169b of the VATD).

While the VATD allows Member States to release taxable persons from the obligation to issue an invoice in the case of exempt supplies (Article 220(2) of the VATD), this is not possible in the case of this particular supply. Self-billing arrangements that follow the self-billing rules of the Member State in

¹⁵²¹ See, e.g., Case C-639/24, *FLO VENEER*. The logic is that denial of the exemption solely on the basis of documentary formal defects would effectively make the exemption contingent on compliance with formal requirements alone.

¹⁵²² Case C-492/13, *Traum*.

¹⁵²³ VATD, Art. 138(1a), one of the "quick fixes" introduced by Council Directive (EU) 2018/1910. See also XVII.P.1.

¹⁵²⁴ VATD, Art. 139.

¹⁵²⁵ VATD, Art. 139.

¹⁵²⁶ Case C-26/16, *Santogal*.

which the supply is made can be used for such deemed B2B transactions.

b. Other Exemptions Carrying Right to Deduct

The VATD enumerates a number of exemptions that are associated with a right to deduct (the transactions concerned often being referred to as “zero-rated” transactions). These exemptions include: (i) exemptions for intra-EU transactions (Articles 140 to 142 of the VATD); (ii) exemptions on importation (Articles 143 to 145 of the VATD); (iii) exemptions on exportation (Articles 146 and 147 of the VATD); (iv) exemptions relating to international transportation (Articles 148 to 150 of the VATD); (v) exemptions relating to certain transactions treated as exports (Articles 151 and 152 of the VATD); (vi) exemptions for the supply of services by intermediaries (Article 153 of the VATD); and (vii) exemptions for transactions relating to international trade (Articles 154 to 166 of the VATD).

J. Deductions

1. Principle of Right to Deduct

a. General

The right of taxable persons to deduct the VAT due or already paid on goods purchased and services received as inputs from the VAT they are liable to pay is a fundamental principle of the common system of VAT established by the relevant EU legislation.¹⁵²⁷ The right to deduct is the cornerstone of the system that ensures the neutrality of VAT¹⁵²⁸ and, from that perspective, it constitutes the translation by the EU legislature, in the area of VAT, of the general principle of equal treatment.¹⁵²⁹

The deduction system established by the VATD is intended to relieve a trader entirely of the burden of the VAT payable or paid in the course of all its economic activities. Thus, the common system of VAT seeks to ensure the complete neutrality of taxation of all economic activities, whatever their purpose or results, provided they are themselves subject, in principle, to VAT.¹⁵³⁰ In other words, the right to deduct input tax is an integral part of the VAT system and, in principle, may not be limited.¹⁵³¹

Insofar as the goods and services concerned are used for purposes of the taxed transactions of a taxable person, the taxable person is entitled, in the Member State in which the per-

son carries out these transactions, to a right to deduct the input VAT that the person is liable to pay.¹⁵³² See the discussion on “qualifying” input VAT at XVII.I.2., below.

The right of deduction arises at the time the deductible tax becomes chargeable.¹⁵³³ Thus, the chargeability of VAT on the underlying transaction and the creation and exercise of the right to deduct are intrinsically linked. In that regard, the right to deduct is independent of whether the consideration, including VAT, *due*¹⁵³⁴ with respect to a transaction has already been paid.¹⁵³⁵

b. “Direct and Immediate Link”

The deduction of input VAT by a taxable person is only permitted to the extent the (acquired) goods and services are used for purposes of its taxed transactions.¹⁵³⁶

In other words, the goods or services acquired must have a direct and immediate link¹⁵³⁷ with taxable (taxed) transactions, meaning that the right to deduct the VAT charged on such goods or services presupposes that the expenditure incurred in obtaining them was part of the cost component of the taxable (taxed) transactions.¹⁵³⁸ Such expenditure must therefore be part of the costs of the output transactions that utilize the goods or services acquired.¹⁵³⁹

In this respect, only the objective relationship between the supplies made and the taxable economic activity is decisive. Consequently, where goods or services acquired by a taxable

¹⁵³² VATD, Art. 168.

¹⁵³³ VATD, Art. 167; Case C-378/02, *Waterschap Zeeuws Vlaanderen*.

¹⁵³⁴ The term “due” refers to an enforceable tax claim and requires the taxable person to have an obligation to pay the amount of VAT that that person seeks to deduct as input VAT. Although VAT becomes chargeable when a supply is made (VATD, Art. 63), VAT found to be chargeable after the time of supply on a supply that was previously thought to be exempt is not deductible if no request for payment of VAT is made by the supplier (Case C-156/20, *Zipvit Ltd v HMRC*).

¹⁵³⁵ Case C-274/10, *Commission v. Hungary*.

¹⁵³⁶ VATD, Art. 168. VAT is in no circumstances deductible with respect to expenditure that is not strictly business expenditure, such as expenditure on luxuries, amusements or entertainment (VATD, Art. 176, first para.).

¹⁵³⁷ It is important to note that the terms “direct and immediate link” and “use” are interchangeable in the sense that the CJEU has used the term “direct and immediate link” to determine whether a cost has been “used” for purposes of an activity giving rise to a right to VAT deduction, within the meaning of VATD, Art. 168.

¹⁵³⁸ Case C-126/14, *Sveda*; see also, Case C-432/15, *Baštová*, in which the CJEU held that a taxable person, who breeds and trains his own race horses and those of other owners, has the right to deduct input VAT on the transactions relating to the preparation for horse races of his own horses and the participation of his own horses in races. The grounds for this decision were that the costs pertaining to those transactions are part of the general costs linked to the taxable person’s economic activity, provided the costs incurred in each of those transactions have a direct and immediate link with that overall activity, which may be the case if the costs thus incurred pertain to race horses actually intended for sale or if the participation of those horses in races is, from an objective point of view, a means of promoting the economic activity (where such a right to deduct exists, any prize won by the taxable person on account of the placing of one of his horses in a race is not to be included in the taxable amount for VAT purposes).

¹⁵³⁹ See, e.g., Case C-132/16, *Iberdrola Inmobiliaria*: a taxable person has the right to deduct input VAT with respect to a supply of services consisting of the construction or improvement of a property owned by a third party when that third party enjoys the results of those services free of charge and the services are used both by the taxable person and by the third party in the context of their economic activity, insofar as those services do not exceed that which is necessary to allow the taxable person to carry out the taxable output transactions and their cost is included in the price of those transactions.

¹⁵²⁷ Case C-78/00, *Commission v. Italy*; Case C-25/07, *Sosnowska*; and Case C-107/10, *Enel Maritsa*.

¹⁵²⁸ Case 268/83, *Rompelman*; Case 50/87, *Commission v. France*; Case C-98/98, *Midland Bank plc*; Case C-408/98, *Abbey National plc*; Case C-16/00, *Cibo*; Case C-25/07, *Sosnowska*; Case C-74/08, *PARAT*; Case C-174/08, *NCC Construction Denmark*; Joined Cases C-536/08 and 539/08, *Facet BV — Facet Trading BV*.

¹⁵²⁹ Case C-309/06, *Marks & Spencer*.

¹⁵³⁰ Case C-408/98, *Abbey National*.

¹⁵³¹ Case 465/03, *Kretztechnik*; Case C-437/06, *Securenta*; Case C-102/08, *SALIX*; Case C-29/08, *Skatteverket v. AB SKF*. See also Case C-590/13, *Idexx Laboratories Italia*, in which the CJEU indicated that failure to comply with formal obligations cannot result in the loss of the deduction right. According to the Court, the fundamental principle of VAT neutrality, in the context of the reverse charge procedure in the case at hand, requires the deduction of input tax to be allowed if the substantive requirements are met, even if the taxpayer has failed to comply with some of the formal obligations. This may not be the case if non-compliance with the formal obligations has the purpose of preventing the control of the meeting of the substantive requirements.

person are used for purposes of transactions that are exempt or do not fall within the scope of VAT, no input tax can, in principle, be deducted.¹⁵⁴⁰ However, where specific costs related to inputs cannot be linked directly to taxed or exempt transactions, but (nonetheless) form part of the overhead relating to a clearly defined part of a taxable person's economic activities, the related VAT should still be considered fully deductible if all the transactions in that "clearly defined part" are taxed.¹⁵⁴¹ Similarly, where the costs of goods and services can be regarded as forming part of the taxable person's "general costs" and, as such, are included in the price of the goods or services that the taxable person supplies, the related VAT is deductible to the extent the economic activity consists of carrying out taxed transactions.¹⁵⁴²

If none of the preceding criteria (i.e., "costs directly linked with taxed transactions," "overheads relating to a clearly defined part of a taxable person's economic activities" or "general costs included in the prices of the goods or services supplied by the taxable person within the person's economic activity") lead to a (full or partial) right to deduct, input VAT cannot be deducted.

c. Economic vs. Non-Economic Activities

As regards the determination of the right to deduct input VAT paid in the case of a taxable person simultaneously carrying on economic activities and non-economic activities, the guiding principle is that the input VAT relating to expenditure incurred by a taxable person cannot give rise to a right to deduct to the extent it relates to activities that, in view of their non-economic nature, do not come within the scope of VAT. Thus, where a taxable person simultaneously carries on economic activities, whether taxed or exempt, and non-economic activities outside the scope of VAT, the deduction of input VAT relating to expenditure is allowed only to the extent that expenditure may be attributed as an output to the economic activity of the taxable person.¹⁵⁴³ It follows that the right to deduct is highly influenced by — and, in a sense, predicated on — the (evolving) views on the concept of "taxable person" and, more specifically, the concept of "economic activity," with the implication that CJEU case law regarding these concepts (see XVII.C., above) is accordingly relevant in terms of the right to deduct.

The CJEU's decisions of July 16, 2015, in *Larentia + Minerva and Marenave*,¹⁵⁴⁴ are illustrative in this respect. Accord-

ing to the Court, expenditure connected with the acquisition of shareholdings in subsidiaries incurred by a holding company that involves itself in their management and, on that basis, carries on an economic activity must be regarded as belonging to the holding company's general expenditure and the VAT paid on that expenditure must, in principle, be deducted in full. However, expenditure connected with the acquisition of shareholdings in subsidiaries incurred by a holding company that involves itself in the management only of some of those subsidiaries and that, with regard to the others, does not, by contrast, carry out an economic activity must be regarded as only partially belonging to the holding company's general expenditure. VAT paid on that expenditure may therefore be deducted only in proportion to that which relates to the economic activity. This proportion must be determined in accordance with the apportionment criteria established by the Member States. In exercising their power to establish such criteria, the Member States must have regard to the aims and broad logic of the Sixth Directive and, on that basis, provide for a method of calculation that objectively reflects the part of the input expenditure actually to be attributed to, respectively, economic and non-economic activity.

d. The Specific Case of Holding Companies

The application of the criteria set out at XVII.J.1.b. and c., above¹⁵⁴⁵ to a holding company, depending on whether the holding company at issue qualifies as a passive, active or mixed holding company, would result in the typology set out in XVII.J.1.d.(1), (2) and (3), below, which makes a further distinction between share acquisition costs and ongoing costs (group audit fees, group legal fees, stock exchange listing fees, regulatory fees, etc.).

(1) Passive Holdings

As regards passive holdings, i.e. holding companies whose sole purpose is to acquire and hold shares, there is consensus that this activity, of itself, is not an economic activity and thus does not give rise to any entitlement to input VAT deductibility. This holds true for both share acquisition costs and ongoing costs. This position is confirmed by *Polysar*:¹⁵⁴⁶ a holding company whose sole purpose is to acquire holdings in other undertakings, without involving itself directly or indirectly in the management of those undertakings, without prejudice to its rights as shareholder, does not have the status of a taxable person for VAT purposes and therefore has no right to deduct tax. Consistent with *Polysar*, the CJEU held in *Sofitam*¹⁵⁴⁷ that since the receipt of dividends is not consideration for any economic activity within the meaning of the VATD, it does not fall within the scope of VAT and, consequently, dividends derived from holdings do not qualify for the deduction of input tax. The same reasoning and conclusion may be found in *Cibo Participations*.¹⁵⁴⁸

¹⁵⁴⁰ Case C-184/04, *Uudenkaupungin kaupunki*; Case C-72/05, *Wollny*.

¹⁵⁴¹ Case C-408/98, *Abbey National plc*.

¹⁵⁴² Case C-465/03, *Kretztechnik*. In the same vein, in the context of a business consisting *inter alia* in offering supplies of motor vehicles by hire purchase, even where the general costs relating to the supplies are passed on not in the amount due by the customer with respect to the supply of the goods concerned (i.e., the taxable part of the transaction), but in the amount of the interest due with respect to the "finance part" of the transaction (i.e., the exempt part), those general costs must nonetheless be considered, for the purposes of VAT, to be a component of the price of that supply. Case C-153/17, *Volkswagen Financial Services* interpreting the Court's statement in Case C-98/98, *Midland Bank Plc* that overhead costs "are part of the taxable person's general costs and are, as such, components of the price of an undertaking's products". See also XVII.D.5. See, more recently, Case C-621/19, *Weindel Logistik* (Order of the Court).

¹⁵⁴³ Case C-437/06, *Securenta*; see also Case C-515/07, *Vereniging Noordelijke Land-en Tuinbouw Organisatie*.

¹⁵⁴⁴ Joined Cases C-108/14 and C-109/14, *Larentia + Minerva*.

¹⁵⁴⁵ To be read in conjunction with the discussion at XVII.C.2.a.

¹⁵⁴⁶ Case C-60/90, *Polysar*.

¹⁵⁴⁷ Case C-333/91, *Sofitam*.

¹⁵⁴⁸ Case C-16/00, *Cibo Participations*.

(2) Active Holdings

Active holdings, i.e. holding companies that, in the context of their shareholding activities, acquire holdings in other undertakings and are involved in the management of those undertakings via the provision of management services, must be regarded as being engaged in an economic activity that is chargeable to VAT.¹⁵⁴⁹ Building on earlier case law,¹⁵⁵⁰ *Marle Participations*¹⁵⁵¹ indicates that a holding should be considered involved in the management of companies in which it has acquired a shareholding where such involvement entails carrying out transactions that are subject to VAT, such as the supply by the holding company to its subsidiaries of administrative, accounting, financial, commercial, information technology and technical services. Admittedly, these examples of involvement should not be seen as exhaustive. Rather, the involvement criterion should be construed as covering all transactions constituting an economic activity, within the meaning of the VATD, performed by the holding company for the benefit of its subsidiaries. As it is thus regarded as engaged in economic activities (i.e., the provision of management services chargeable to VAT), an active holding company is entitled to deduct VAT incurred on the costs that have a direct and immediate link to the provision of those taxable services and on the costs that are general costs of the holding company that have a direct and immediate link to the holding company's taxable economic activity as a whole. This is confirmed by *Larentia + Minerva*,¹⁵⁵² in which the CJEU held that expenditure connected with the acquisition of shareholdings in subsidiaries incurred by a holding company that involves itself in the management of those subsidiaries and that, on that basis, carries on an economic activity must be regarded as belonging to its general expenditure and the VAT paid on that expenditure must, in principle, be deducted in full. The same holds true for ongoing costs incurred by such an active holding company. By contrast, in *Finanzamt R*,¹⁵⁵³ an active holding company that carries out taxable output transactions in favor of subsidiaries is held not to be entitled to deduct the input tax levied on the services that it obtains from third parties and that it supplies to the subsidiaries in return for the granting of a share in the general profit, where the input services: (i) have direct and immediate links not to the holding company's own transactions but to the largely tax-exempt activities of the subsidiaries; (ii) are not included in the price of the taxable transactions carried out in favor of the subsidiaries;

¹⁵⁴⁹ See, Case C-142/99, *Floridienne and Berginvest*: "... involvement of that kind in the management of subsidiaries must be regarded as an economic activity ... in so far as it entails carrying out transactions which are subject to VAT ... such as the supply ... of administrative, accounting and information technology services to their subsidiaries." See also Case C-320/17, *Marle Participations*, in which it is stated that the term "involvement of a holding company in the management of its subsidiary" must be understood to cover all transactions constituting an economic activity within the meaning of the VATD.

¹⁵⁵⁰ See, Case C-142/99, *Floridienne and Berginvest*; Case C-16/00, *Cibo Participations*; Case C-496/11, *Portugal Telecom*.

¹⁵⁵¹ Case C-320/17, *Marle Participations*.

¹⁵⁵² Joined Cases C-108/14 and C-109/14, *Larentia + Minerva*.

¹⁵⁵³ Case C-98/21, *Finanzamt R*. In Case C-527/23, *Weatherford Atlas*, the CJEU reminds the principle that no right of deduction can arise from the part of the expenditure incurred by the taxable person that is linked not to transactions carried out by the taxable person itself, but to transactions carried out by a third party. See also Case C-405/19, *Vos Aannemingen*.

and (iii) are not part of the general costs of the holding company's own economic activity.

(3) Mixed Holdings

As regards mixed holding companies, i.e., holding companies involved in both passive and active shareholding activities (i.e., economic and noneconomic activities) simultaneously, the position is that a right to deduct only arises with respect to input VAT on costs that have a direct and immediate link to the company's economic activities or general costs that have a direct and immediate link to that part of the company's economic activities as a whole. Where acquisition costs are related to both the economic activity of providing taxable management services and the non-economic activity of passively holding shares, the input VAT incurred by the mixed holding company should be apportioned to ensure that VAT deductibility only arises with respect to the portion of those costs that are used for purposes of the taxable economic activity. This is confirmed in *Larentia + Minerva*,¹⁵⁵⁴ in which the CJEU held that expenditure connected with the acquisition of shareholdings in subsidiaries incurred by a holding company that involves itself in the management only of some of those subsidiaries and that, with regard to the others, does not, by contrast, carry on an economic activity must be regarded as only partially belonging to its general expenditure. The VAT paid on that expenditure may be deducted only in proportion to that which relates to the economic activity. This proportion must be determined in accordance with the apportionment criteria established by the Member States. In exercising their power to establish such criteria, the Member States must have regard to the aims and broad logic of the VATD and, on that basis, provide for a method of calculation that objectively reflects the part of the input expenditure actually to be attributed to, respectively, economic and non-economic activity.¹⁵⁵⁵ The same conclusion applies, *mutatis mutandis*, to a mixed holding company's ongoing costs.

2. Input VAT

For purposes of the right to deduct, "input VAT" encompasses the following categories:

- (i) To the extent goods and services are (exclusively) used for purposes of the taxed transactions of a taxable person, the taxable person is entitled, in the Member State in

¹⁵⁵⁴ Joined Cases C-108/14 and C-109/14, *Larentia + Minerva*.

¹⁵⁵⁵ However, a mixed holding company whose involvement in the management of its subsidiaries is recurrent is not entitled to deduct input VAT on the commission paid to a credit institution for organizing and putting together a bond loan that was earmarked for making investments in a given sector, where those investments were not ultimately made and the capital obtained by means of the loan was advanced in full to the parent company of the group in the form of a loan. The actual use to which the capital is put (i.e., the loan to the parent company) takes precedence over the planned taxable use of the capital, resulting in a direct link between the capital raising costs and a VAT exempt transaction with the consequence that there is no right to deduct VAT incurred on the costs concerned (Case C-42/19, *Sonaecom*). The same conclusion prevails in the case of a holding company carrying on an economic activity consisting in providing management services to its sub-subsidiary whose shares (together with those of the intermediate subsidiary) were the subject of an abortive sale. Such a share disposal transaction (i.e., one that is envisaged but not carried out), the direct and exclusive reason for which does not lie in the taxable economic activity of the company concerned, or that does not constitute the direct, permanent and necessary extension of that economic activity, does not fall within the scope of VAT (Case C-502/17, *C&D Foods Acquisition*).

which it carries out these transactions, to deduct input VAT from the VAT it is liable to pay, i.e. the VAT: (i) due or paid in that Member State with respect to supplies to it¹⁵⁵⁶ of goods or services carried out or to be carried out by another taxable person (VAT charged and VAT payable under the reverse charged system (see XVII.K.1.b., below); (ii) due with respect to internal supplies treated as supplies of goods or services (see XVII.D.1.a.(2) and D.3.a., above); (iii) due with respect to intra-EU acquisitions of goods; (iv) due on certain transactions assimilated to intra-EU acquisitions (see XVII.D.2., above); and (v) due or paid¹⁵⁵⁷ with respect to the importation of goods into that Member State.¹⁵⁵⁸

(ii) A taxable person is also entitled to deduct the relevant VAT to the extent the goods and services are used for transactions: (i) relating to activities referred to in the second subparagraph of Article 9(1) of the VATD (i.e., the definition of “economic activity”) carried on outside the Member State¹⁵⁵⁹ in which that tax is due or paid, with respect to which VAT would be deductible if the transactions had been carried out within that Member State; (ii) falling within the scope of the exemptions relating to the intra-EU supply of goods (see XVII.I.3.a., above), certain transportation services, importations, international transportation, certain transactions treated as exports, the supply of services by intermediaries or international trade (i.e., zero-rated transactions — see XVII.I.3.b., above); and (iii) that are exempt under Article 135(1)(a) to (f) of the VATD (see XVII.I.2.b., above), where the customer is established outside the European Union or where those transactions relate directly to goods to be exported out of the European Union.¹⁵⁶⁰

(iii) VAT on expenditure related to immovable property forming part of the business assets of a taxable person and used both for purposes of the taxable person’s business and his or her private use or that of his or her staff (or, more generally, for purposes other than those of the business) is deductible only up to the proportion of the property’s use for purposes of the taxable person’s business.¹⁵⁶¹

¹⁵⁵⁶ Case C-153/11, *Klub*: it is the acquisition of the goods by a taxable person acting as such that determines the application of the VAT system and therefore of the deduction mechanism (see also Case C-97/90, *Lennartz*, and Case C-118/11, *Eon Aset Menidjment*).

¹⁵⁵⁷ See Case C-414/10, *Société Veleclair*.

¹⁵⁵⁸ VATD, Art. 168. See also Case C-227/21, *HA.EN*, in which the CJEU held (on September 15, 2022) that the tax authorities of a Member State cannot, from the perspective of EU law, legitimately take the view that, in the context of the sale of an item of immovable property between taxable persons following a statutory compulsory sale procedure, the mere fact the purchaser knew or should have known that the vendor was in financial difficulties that could result in the vendor not paying VAT into the public purse, means that the purchaser committed an abuse of rights. The authorities may therefore deny the purchaser the right to deduct input VAT. In light of the *prima facie* legitimate objective that it pursues, such a transaction cannot be equated with a wholly artificial arrangement that does not reflect economic reality and is set up with the sole aim of obtaining a tax advantage, which the principle that abusive practices are prohibited has the effect of barring.

¹⁵⁵⁹ Case C-377/08, *EGN*.

¹⁵⁶⁰ VATD, Art. 169.

¹⁵⁶¹ VATD, Art. 168a(1); for this purpose, changes over time in the proportion of use of immovable property are taken into account.

Member States may extend this rule to VAT on such expenditure related to other goods forming part of the business assets as they may specify.¹⁵⁶²

(iv) Any person that is regarded as a taxable person by reason of the fact that it makes an exempt intra-EU supply, on an occasional basis, of a new means of transport is entitled, in the Member State in which the supply takes place, to deduct the VAT included in the purchase price or paid with respect to the importation or intra-EU acquisition of the means of transport, up to an amount not exceeding the amount of VAT for which it would be liable if the supply were not exempt. The right of deduction arises and may be exercised only at the time of supply of the new means of transport.¹⁵⁶³

In *Ferimet*,¹⁵⁶⁴ the CJEU provided guidance on the right to recover VAT being subject to the material conditions that the supplier is a taxable person for VAT purposes and the recipient uses the procured goods and services for its own VAT-taxed output transactions. *Ferimet* had concealed the true identity of a supplier, as a result of which the Spanish tax authorities were not able to determine if the first condition was fulfilled. Based on this, the CJEU reasoned that *Ferimet* should be denied the right to recover the self-charged VAT amount. Specifically, the Court held that a taxable person must be refused the right to deduct VAT relating to the acquisition of goods supplied to the taxable person where the person knowingly indicated a fictitious supplier on the invoice that the taxable person issued with respect to that transaction under the reverse charge procedure, if, taking into account the factual circumstances and the evidence provided by the taxable person: (i) the information necessary to verify that the true supplier had the status of a taxable person is lacking; or (ii) it is established to the requisite legal standard that the taxable person has committed VAT fraud or knew or ought to have known that the transaction relied on as a basis for the right of deduction was connected with such fraud. A variation on the same theme can be found in *Kemwater Prochemie*.¹⁵⁶⁵ In this case, the CJEU held, referring to *Ferimet*, that the right to deduct input VAT must be refused, without the tax authorities having to prove that the taxable person committed VAT fraud or knew, or ought to have known, that the transaction relied on to establish the right of deduction was connected with such fraud, where, the true supplier of the goods or services concerned not having been identified, the taxable person fails to adduce proof that that supplier had the status of a taxable person, if, taking into account the factual circumstances and the evidence produced by the taxable person, the information needed to verify that the true supplier had that status is lacking. In *Aquila Part Prod Com*,¹⁵⁶⁶ the CJEU made it clear that it lies with the tax authorities intending to refuse the right to deduct to prove the existence of VAT fraud and provide evidence that the taxable person either committed this fraud or at least knew or should have known that a given transaction was related to such fraud. However, the mere fact that the entities

¹⁵⁶² VATD, Art. 168a(2).

¹⁵⁶³ VATD, Art. 172.

¹⁵⁶⁴ Case C-281/20, *Ferimet*.

¹⁵⁶⁵ Case C-254/20, *Kemwater Petrochemie*.

¹⁵⁶⁶ Case C-512/21, *Aquila Part Prod Com*.

participating in the supply chain concerned knew each other is not sufficient evidence to prove the taxpayer's involvement in the fraud. Also, the tax authorities may not require a taxpayer to carry out a comprehensive and thorough verification of the supplier, thus transferring to that taxpayer the obligation to carry out in-depth verification/due diligence activities. In particular, the tax authorities may not generally require a taxable person wishing to exercise the right to deduct VAT to ascertain: (i) on the one hand, whether the issuer of the invoice relating to the goods or services for which exercise of that right is sought has the status of a taxable person, has the goods in question and is able to deliver them, and is in compliance with the obligation to declare and pay VAT, to ensure that there are no irregularities or fraud; and (ii), on the other, that it has documents confirming this.

A taxable person is not entitled to claim input VAT on a supply charged at a price expressed to be exclusive of VAT and treated as exempt, and subsequently found to be a taxable supply, unless an amount of VAT was actually charged by the supplier after the amount was found to be taxable.¹⁵⁶⁷

Mere formal defects in an invoice, such as an incorrect delivery date, do not automatically invalidate the right to deduct VAT, provided the substantive conditions for deduction are met. Additionally, rectification of an invoice is not a prerequisite for exercising the right to deduct VAT if the necessary information is available. To justify a refusal of the right to deduct VAT, the relevant tax administration must establish to the sufficient legal standard that the taxable person actively participated in VAT fraud or that the taxable person knew or should have known that the issuer of the invoice had committed such fraud.¹⁵⁶⁸

Articles 168 and 203 of the VATD, as well as the principles of the neutrality of VAT and effectiveness, must be interpreted as not precluding national legislation or a national administrative practice that does not allow a taxable person to obtain the deduction of the input VAT on a transaction which, following a tax audit, has been reclassified by the tax authorities as a transaction not subject to VAT. However, those principles require that, in such a situation, the taxable person concerned be able to apply directly to the tax authorities for reimbursement.¹⁵⁶⁹

3. Refund

Deductible VAT results in a right to a refund where the amount of the deductible VAT cannot be fully set off against the amount of VAT due.

All taxable persons not established in the Member State in which they purchase goods and services or import goods subject to VAT are entitled to obtain a refund of that VAT to the extent the goods and services are used for purposes of: (i) transactions relating to the activities referred to in the second subparagraph of Article 9(1) of the VATD (i.e., the definition of "economic activity") carried on outside the Member State in which that tax is due or paid, with respect to which VAT would be deductible if they had been carried out within that Mem-

ber State (see XVII.I.3.a., above); (ii) transactions falling within the scope of the exemptions related to the intra-EU supply of goods, certain transport services, importations, international transport, certain transactions treated as exports, the supply of services by intermediaries or international trade (i.e., zero-rated transactions; see XVII.I.3., above); (iii) transactions that are exempt under Article 135(1)(a) to (f) of the VATD (see XVII.I.2.b., above), where the customer is established outside the European Union or where the transactions relate directly to goods to be exported out of the European Union; and (iv) transactions with respect to which VAT is solely payable by the customer under the reverse charge mechanism.¹⁵⁷⁰

The refund of VAT to taxable persons that are not established within the territory of the Member State concerned but are established in another Member State must be made in accordance with Council Directive 2008/9/EC (which provides for a full electronic procedure replacing the previous (costly and cumbersome) Eighth VAT Directive paper system with effect from January 1, 2010).¹⁵⁷¹ Refunds of VAT to taxable persons not established within the territory of the European Union must be made in accordance with Council Directive 86/560/EEC, better known as the Thirteenth VAT Directive.¹⁵⁷²

The Reemtsma principle is a principle developed by the CJEU in *Reemtsma Cigarettenfabriken*.¹⁵⁷³ Under this principle, the recipient of an invoice reflecting VAT that is not due has a "direct right" to obtain a refund of that VAT from the tax authority when the supplier is unable or unwilling to correct the overcharge, i.e., when recovering unduly paid VAT from a supplier is "impossible or excessively difficult." A VAT refund can only be claimed when there is no fraud, abuse or negligence, and no risk to tax revenues. The principle provides an exception to the general rule that if a supplier incorrectly charges VAT, the recipient must seek reimbursement from the supplier. Subsequent case law has clarified the scope of the principle as well as its boundaries. *HUMDA*¹⁵⁷⁴ is a case that concerns VAT incorrectly charged on services related to cross-border land transactions and the implications of the insolvency of a supplier for the recovery of VAT. The CJEU held that the Reemtsma principle also applies in cross-border transactions when VAT is charged incorrectly as a result of the misapplication of the place of supply rules and recovery through the supplier is no longer possible. In *Schütte*,¹⁵⁷⁵ a case that dealt with missed deadlines for VAT correction, the CJEU held that a pur-

¹⁵⁷⁰ VATD, Art. 170. With regard to transactions on which the tax is solely payable by the customer under the reverse charge mechanism, Member States may, instead of granting a refund of VAT, allow a deduction of VAT (VATD, Art. 171a).

¹⁵⁷¹ VATD, Art. 171(1).

¹⁵⁷² VATD, Art. 172(2). See Case C-562/17, *Nestrade*, in which the CJEU held that, since it is not governed by the Thirteenth Directive, the enactment of measures laying down a limitation period the expiry of which has the effect of penalizing a taxable person that has not been sufficiently diligent and has failed to rectify incorrect or incomplete invoices for purposes of exercising the right to a VAT refund is a matter for national law, provided that procedure: (i) applies in the same way to analogous rights in tax matters founded on national law and to those founded on EU law (principle of equivalence); and (ii) does not in practice render impossible or excessively difficult the exercise of that right (principle of effectiveness). See (by analogy) Joined Cases C-95/07 and 96/07, *Ecotrade* and Case C-81/17, *Zabrus Siret*.

¹⁵⁷³ Case C-35/05, *Reemtsma Cigarettenfabriken*.

¹⁵⁷⁴ Case C-397/21, *HUMDA*.

¹⁵⁷⁵ Case C-453/22, *Schütte*.

¹⁵⁶⁷ Case C-156/20, *Zipvit Ltd v. HMRC*.

¹⁵⁶⁸ Case C-270/24, *Granulines Invest* (Order of the Court).

¹⁵⁶⁹ Case C-640/23, *Greentech*.

chaser should not lose the right to the reimbursement of VAT simply because the supplier's correction window has closed. A similar judgment was rendered in *Greentech*.¹⁵⁷⁶ In *H GmbH*,¹⁵⁷⁷ the CJEU emphasized that there are limits to the Reemtsma principle. For example, a taxpayer cannot claim a VAT refund if its supplier has already received a refund as that would mean the authorities were paying twice for the same claim, which, according to the Court, runs counter to the EU principle of VAT neutrality. This applies even if the supplier has already claimed the refund when it goes into liquidation.

4. Proportional Deduction

In the case of goods or services used by a taxable person for both: (i) taxed transactions with respect to which VAT is deductible (or transactions that are zero-rated, i.e., that are exempt but carry a right to deduct); and (ii) transactions that are exempt and carry no right to deduct, with respect to which VAT is not deductible, only such proportion of the VAT as is attributable to the taxed and zero-rated transactions is deductible, i.e., “*pro rata* deduction.”¹⁵⁷⁸

To this end, Member States may: (i) authorize or require a taxable person to determine a proportion for each sector of the person's business, provided separate accounts are kept for each sector (“direct attribution to business sectors” method); (ii) authorize or require a taxable person to make the deduction based on the use made of all or part of the goods and services (“actual use” method); (iii) authorize or require a taxable person to make the deduction in accordance with a general *pro rata* apportionment with respect to the goods and services used for taxed and exempt transactions; or (iv) provide that, where the VAT that is not deductible by a taxable person is insignificant, such VAT is to be treated as nil (*de minimis* rule).¹⁵⁷⁹

The deductible proportion is made up of a fraction comprising: (i) a numerator equal to the total amount, exclusive of VAT, of turnover per year attributable to transactions with respect to which VAT is deductible; and (ii) a denominator equal to the total amount, exclusive of VAT, of turnover per year attributable to transactions included in the numerator and to transactions with respect to which VAT is not deductible. Member States may include in the denominator the amount of subsidies, other than those directly linked to the price of supplies of goods or services.¹⁵⁸⁰ The following amounts are to be excluded from the calculation of the deductible portion: (i) the amount of turnover attributable to supplies of capital goods

used by the taxable person for purposes of its business; (ii) the amount of turnover attributable to incidental real estate and financial transactions; and (iii) the amount of turnover attributable to the transactions specified in Article 135(1)(b) to (g) of the VATD, to the extent such transactions are incidental.¹⁵⁸¹

The VATD does not currently contain any rules regarding the deduction of input VAT with respect to revenue generated outside the country of establishment. In *Le Crédit Lyonnais*,¹⁵⁸² the CJEU provided guidance in this respect. The case concerned *Crédit Lyonnais*, which sought to include the value of loan interest provided by its head office to non-EU branches in its *pro rata* calculation. Arguing that a head office and its branches are the same legal entity, the French tax authorities refused to allow the inclusion. The CJEU concluded that in determining the deductible proportion of VAT, a company that has its principal establishment in a Member State may not take into account the turnover of its branches established abroad (whether in other Member States or in third countries). The Court also decided that the ability of Member States to authorize the calculation of the deductible proportion per sector of business does not extend to authorizing a company to take into account the turnover of a foreign branch in its deductible proportion. In *Morgan Stanley & Co International*,¹⁵⁸³ the CJEU nuanced its holding in *Le Crédit Lyonnais* by emphasizing that that holding does not rule out the turnover of foreign branches being taken into account when determining the recovery right. Specifically, the CJEU ruled that, in relation to expenditure borne by a branch registered in a Member State that is used exclusively both for transactions subject to VAT and for transactions exempt from VAT carried out by the principal establishment of that branch established in another Member State, it is necessary to apply a deductible proportion resulting from a fraction. The denominator of that fraction is formed by the turnover, exclusive of VAT, made up of those transactions alone and the numerator is formed by the taxed transactions with respect to which VAT would also be deductible had they been carried out in the Member State in which the branch is registered. This includes the circumstances in which the right to deduct derives from the exercise of an option, effected by the branch, to have the transactions carried out in that State subject to VAT. On the other hand, to determine the deductible proportion applicable to the general costs of a branch registered in a Member State that are used for both transactions of that branch in that State and transactions of the principal establishment of that branch established in another Member State, account must be taken, in the denominator of the fraction making up the deductible proportion, of the transactions carried out by both the branch and the principal establishment. Specifically, it is necessary that there should appear, in the numerator of the fraction, besides the taxed transactions carried out by the branch, only the taxed transactions carried out by the principal establishment with respect to which VAT would also be deductible had the transactions been carried out in the State in which the branch is registered. *Prima facie*, this might appear to contradict the holding in *Le Crédit Lyonnais*. However, the inclusion of the turnover made by the head office is justified because in-

¹⁵⁷⁶ Case C-640/23, *Greentech*.

¹⁵⁷⁷ Case C-83/23, *H GmbH*.

¹⁵⁷⁸ VATD, Art. 173.

¹⁵⁷⁹ See, e.g., Case C-511/10, *BLC Baumarkt*. The case concerned a company that had a building built that was let after completion. The letting was partly exempt and partly subject to VAT. The company computed the deductible input VAT by applying a *pro rata* calculation based on the ratio between the turnover in relation to the commercial letting and the turnover arising from other letting transactions. The German VAT Authorities challenged this position taking the view that the amount of deductible input VAT had to be determined according to the ratio between the area of the commercial premises and the area of the premises used for living accommodation. The CJEU held that Member States are allowed, for purposes of calculating the proportion of input VAT deductible for a given operation, to give precedence to an allocation key other than that based on the VAT *pro rata* calculation, if the method used guarantees a more precise determination of the deductible proportion.

¹⁵⁸⁰ VATD, Art. 174(1).

¹⁵⁸¹ VATD, Art. 174(2).

¹⁵⁸² Case C-388/11, *Le Crédit Lyonnais*.

¹⁵⁸³ Case C-165/17, *Morgan Stanley & Co International*.

put tax incurred by a branch for purposes of supporting its head office presents a link with the output activities of the head office.

Nor does the VATD cover the situation in which costs can be attributed to both taxable (whether taxed or exempt) and non-taxable transactions. In *Securenta*,¹⁵⁸⁴ the CJEU held that the Member States have the discretion to determine the methods and criteria for apportioning input VAT between economic and non-economic activities. In exercising that discretion, the Member States must have regard to the aims and broad logic of the VATD and, on that basis, provide for a method of calculation that objectively reflects the part of the input expenditure to be attributed to the economic and that to be attributed to the non-economic activities. This is particularly relevant for a holding company (which is, in principle, a non-taxable person) that also carries out activities with respect to which it qualifies as a taxable person. According to the CJEU's reasoning, the tax authorities must determine an appropriate VAT deduction mechanism for such cases, while objectively and separately reflecting the expenses attributed to the activities with respect to which the company qualifies as a taxable person, and the activities with respect to which it does not qualify as a taxable person. This is illustrated by *Portugal Telecom SGPS*,¹⁵⁸⁵ in which the CJEU held that a holding company that, in addition to its main activity of managing shares in companies in which it holds all or part of the share capital, acquires goods and services that it subsequently invoices to those companies, is authorized to deduct input VAT provided the input services acquired have a direct and immediate link with the output economic transactions giving rise to a right to deduct. Where those goods and services are used for both economic and non-economic activities, the methods of deduction and apportionment are to be defined by the Member States. In exercising their power to establish such criteria, the Member States must take account of the purpose and general scheme of the VATD and, on that basis, lay down a method of calculation that objectively reflects the input expenditure actually attributable to each of the two activities.¹⁵⁸⁶

5. Rules Governing Exercise of Right of Deduction

The rules governing the exercise of the right to deduct input VAT are set out in Articles 178 to 183 of the VATD.

The right to deduct is to be exercised, as a rule, by subtracting from the amount of VAT due for a given tax period the amount of VAT for which, during the same period, the right of deduction arises.¹⁵⁸⁷ In principle, the right to deduct must be

¹⁵⁸⁴ Case C-437/06, *Securenta*.

¹⁵⁸⁵ Case C-496/11, *Portugal Telecom SGPS*.

¹⁵⁸⁶ This position has been reiterated in Joined Cases C-108/14 and C-109/14, *Larentia + Minerva and Marenave*: Where a holding company actively manages some subsidiaries, and is a passive shareholder in others, its costs will not have a "direct and immediate link" with the company's economic activity as a whole to the extent those costs relate to subsidiaries in which it is a passive shareholder. Such a "mixed" holding company may only recover input tax to the extent it is attributable to the proportion of the company's activity that constitutes economic activity. The relevant Member State must decide the method for determining the *pro rata* recovery of input tax, thereby having due regard to the purpose and general scheme of the VATD. See also XVII.C.3.c., above.

¹⁵⁸⁷ Joined Cases C-95/07 and C-96/07, *Ecotrade*. See also Case C-518/14, *Senatex*: the VATD precludes national legislation under which the correction of an invoice in relation to a detail that must be mentioned, namely the

exercised with respect to the tax period in which the applicable conditions are fulfilled, i.e., that the goods have been delivered or the services performed and that the taxable person holds the invoice or the document that, according to the criteria determined by the Member State in question, may be considered to serve as an invoice.¹⁵⁸⁸ However, in *Volkswagen*,¹⁵⁸⁹ the CJEU held that, although the right to deduct VAT arises at the same time as VAT becomes chargeable, it only can be properly exercised once the VAT taxable person holds an invoice referring to that VAT. In *Volkswagen*, the suppliers did not make any adjustments for VAT purposes (for goods supplied between 2004 and 2010) until 2010, when they issued corrective invoices showing VAT, sent supplementary tax returns to the competent national authority and paid the amount of VAT due to the State Treasury. In these circumstances, it was objectively impossible for Volkswagen to exercise its right to a refund before this adjustment, as, prior to that, it had neither been in possession of the invoices nor was it aware that VAT was due. The CJEU also noted that the risk of tax evasion was non-existent in the case at hand as VAT had already been accounted for by the supplier in the context of the regularization. Consequently, the CJEU held that, if a VAT taxable person is able to demonstrate that it was objectively impossible to exercise the right to recover VAT before the national limitation period expired, the Member State in question cannot deny that VAT recovery solely because the national limitation period has expired.

Referring to *Volkswagen*, the CJEU reiterated in *Wilo Salmson Franse SAS*¹⁵⁹⁰ that the right to recover input VAT is subject to the twofold condition that the supplier has become liable for the VAT payment and the recipient of the supply possesses an invoice that meets all invoicing requirements. Those two conditions determine the period in which the right to recover VAT has to be exercised and the point at which any time limit commences. An invoice exists when it includes information on the supplier, the recipient of the supply, the goods or services supplied, the price and the VAT amount, which must be charged separately.

VAT registration is a formal requirement that cannot compromise a taxable person's right to recover VAT, if and insofar as the material conditions for VAT recovery have been fulfilled.¹⁵⁹¹ Thus, when a tax authority, based on national legislation, makes the right to deduct VAT subject to compliance with formal obligations, such as the identification for VAT purposes, without taking into account substantive requirements and, in particular, without examining whether those requirements are met, the tax authority is going further than is necessary to ensure the correct collection of the tax. The same conclusion must be reached when a tax authority, acting in accordance with national legislation, systematically decides not to assign a VAT

VAT identification number, does not have retroactive effect, so that the right to deduct VAT exercised based on the corrected invoice relates not to the year in which the invoice was originally drawn up but to the year in which it was corrected.

¹⁵⁸⁸ Case C-152/02, *Terra Baubedarf-Handel*. Member States may provide for a limitation period for exercising the right to deduct, provided the principles of equivalence and effectiveness are observed (Case C-332/15, *Astone*).

¹⁵⁸⁹ Case C-533/16, *Volkswagen*.

¹⁵⁹⁰ Case C-80/20, *Wilo Salmson Franse SAS*.

¹⁵⁹¹ Case C-358/20, *Promexor Trade*.

identification number to a taxable person solely because its director is a partner in another company that is subject to insolvency proceedings, without, however, examining whether there is a risk to the correct collection of VAT or a risk of evasion.

Nor may the exercise of the right to deduct input VAT be made subject to the condition that the address at which the issuer of an invoice carries on its economic activity is indicated on the invoice.¹⁵⁹²

As regards the possibility, under Article 183 of the VATD, of providing that excess VAT is to be carried forward to the following tax period or refunded, the CJEU has made it clear that the conditions for the refund of excess VAT cannot undermine the principle of fiscal neutrality by making the taxable person bear the burden of the VAT, in whole or in part.¹⁵⁹³ In particular, such conditions must enable the taxable person, in the appropriate circumstances, to recover the entirety of the credit arising from the excess VAT. This means that a refund must be made within a reasonable period of time by a payment in liquid funds or equivalent means, and that, in any event, the method of refund adopted may not entail any financial risk for the taxable person.¹⁵⁹⁴

EU law does not require the payment of interest to a taxable person on a refund of VAT if the refund is partly attributable to the person's errors in deducting input VAT and partly to retroactive changes in the method established by that taxable person for calculating deductible VAT related to general costs.¹⁵⁹⁵

6. Adjustment of Deductions

As already noted, a taxable person can exercise the right to deduct immediately, i.e., the right arises at the time the deductible tax becomes chargeable. At that time, it may not be certain for which purposes the inputs will be used, with the consequence that the initial deduction is based on a reasonable estimate of the future use of the goods or services in question. The provisional nature of the initial deduction means that it may need to be adjusted later in accordance with the actual use to which the inputs were put, i.e., the initial deduction is to be adjusted where it is higher or lower than that to which the taxable person is entitled.¹⁵⁹⁶

In the case of immovable capital goods, if the initial deduction is incorrect and an adjustment is required, the adjustment is spread over a (minimum) period of five years including that in which the goods were acquired or manufactured (the adjustment with respect to other goods and services is made immediately). Member States may base the adjustment on a period of five full years starting from the time at which the goods are first used. The annual adjustment may only be made with

respect to one-fifth of the VAT imposed on the goods. The adjustment period can be extended to up to 20 years.

According to the CJEU, the adjustment mechanism provided for in Articles 184 to 186 of the VATD is an integral part of the VAT deduction scheme established by that directive. It is intended to enhance the precision of deductions so as to ensure the neutrality of VAT: transactions effected at an earlier stage continue to give rise to the right to deduct only to the extent they are used to make supplies subject to VAT. The mechanism thus aims to establish a close and direct relationship between the right to deduct input VAT and the use of the goods or services concerned for taxable output transactions.¹⁵⁹⁷

In Case C-194/21, X, the CJEU held that the VAT revision rules apply only where the taxable person has recovered VAT and cannot give rise to VAT recovery in situations in which the deduction has not been exercised on time or has not been exercised correctly. Referring to earlier case law,¹⁵⁹⁸ the Court held that the ability to exercise the right to deduct VAT without any time limit would be contrary to the principle of legal certainty. That principle requires the tax position of taxable persons, having regard to their rights and obligations *vis-à-vis* the tax authority, not to be open to challenge indefinitely. A limitation period whose expiration has the effect of penalizing a taxable person that has not been sufficiently diligent and has failed to claim deduction of the input VAT by making that person forfeit the right to deduct VAT cannot be regarded as incompatible with the regime established by the VATD, to the extent that the limitation period: (i) applies in the same way both to analogous rights in tax matters founded on domestic law and to those founded on EU law (principle of equivalence); and (ii) does not in practice make the right to deduct VAT impossible or excessively difficult to exercise (principle of effectiveness). The adjustment mechanism provided for in Article 185(1) of the VATD is applicable only where there is a right to deduct VAT.¹⁵⁹⁹ However, Articles 184 and 185 of the VATD cannot give rise to a right to deduct VAT.¹⁶⁰⁰ It follows that the adjustment mechanism is not intended to apply where the taxable person failed to exercise the right to deduct VAT and has lost that right as a result of the expiration of a limitation period. Consequently, the mechanism does not apply in circumstances in which the taxable person that failed to exercise the right to deduct VAT when the goods on which that right is based were acquired wishes to exercise that right when those goods are first used, when the limitation period laid down by domestic law for exercising that right has expired. It is irrelevant, in that regard, whether the first use of the goods differs from that envisaged at the time of their acquisition. That conclusion is not called in question by the principle of fiscal neutrality. While it is true that the adjustment is an integral part of the deduction scheme established by the VATD and is intended to enhance the precision of deductions so as to ensure tax neutrality (a fundamental principle of the common system of VAT put in place by the EU

¹⁵⁹² Joined Cases C-374/16 and C-375/16, *Geissel and Butin*.

¹⁵⁹³ See, e.g., Case C-387/16, *Nidera*, in which the CJEU held that VATD, Art. 183, read in conjunction with the principle of fiscal neutrality, must be interpreted as not permitting a reduction in the amount of interest due to a taxable person by way of default interest for the late refund of overpaid VAT in relation to the amount of interest to which that person would have been entitled under the normal rules, for reasons unconnected with the actions of that person.

¹⁵⁹⁴ See, e.g., Case C-78/00, *Commission v. Italy*; Case C-25/07, *Sosnowska*; and Case C-107/10, *Enel Maritsa*.

¹⁵⁹⁵ Case C-674/22, *Gemeente Dinkelland*.

¹⁵⁹⁶ VATD, Art. 184.

¹⁵⁹⁷ Joined Cases C 660/16 and C 661/16, *Kolloß and Wirtl*.

¹⁵⁹⁸ See Joined Cases C-95/07 and 96/07, *Ecotrade*; Case C-284/11, *EMS-Bulgaria Transport*, and Case C-8/17, *Biosafe — Indústria de Reciclagens*.

¹⁵⁹⁹ See, to that effect, Case C-184/04, *Uudenkaupungin kaupunki*, C-184/04.

¹⁶⁰⁰ See Case C-97/90, *Lennartz* and Case C-378/02, *Waterschap Zeeuws Vlaanderen*.

legislature),¹⁶⁰¹ the principle of fiscal neutrality is not a rule of primary law but a principle of interpretation, to be applied concurrently with other principles, including the principle of legal certainty.¹⁶⁰²

In *Mydibel*,¹⁶⁰³ which concerned a Belgian company entering into two financial transactions in the form of sale and lease back arrangements not subject to VAT (i.e. the granting of long leases on buildings via emphyteutic rights against the payment of emphyteutic rents and the immediate lease-back of the buildings), the CJEU analyzed the requirement for (ordinary) adjustments resulting from a change in the factors used to determine the amount of the deduction and the application of the special adjustment regime for capital goods. Under the ordinary adjustment rule, the Court had to examine whether the sale-and-lease back operations at hand should be regarded as a change in the factors used to determine the amount of the deduction made. In the Court's view, the mere creation of an emphyteutic right not subject to VAT cannot be regarded as having the effect of breaking the close and direct relationship between the right to deduct input VAT and the use of the goods or services concerned for taxable output transactions. The creation of the emphyteutic right did not prevent Mydibel from using the buildings concerned in an uninterrupted and permanent manner for its economic activity. Consequently, as there were no changes in the factors used to determine the amount of the deductions made, Articles 184 and 185 of the VATD did not require an adjustment of the initial VAT deduction in the given circumstances.¹⁶⁰⁴ As regards the special adjustment rule for capital goods laid down in Article 187 of the VATD, the CJEU takes the view that the (simultaneous) combination of an emphyteutic sale lease accompanied by a lease back arrangement, to the extent these are purely financial transactions, does not amount to a supply of goods. The rights transferred to the financial institutions involved following those transactions, i.e., the civil law emphyteutic rights reduced by the rights deriving from the leases of real property of which Mydibel is the beneficiary, do not empower them to dispose of the buildings at issue in the main proceedings as if they were their owners. No adjustment is therefore needed under the special adjustment rule for capital goods.

Articles 184 to 186 of the VATD must be interpreted to the effect that insolvency proceedings cannot automatically result in a requirement to adjust VAT deductions made in relation to the period preceding the insolvency.¹⁶⁰⁵

¹⁶⁰¹ Case C-791/18, *Stichting Schoonzicht*.

¹⁶⁰² See, by analogy, Case C-44/11, *Deutsche Bank*, C-44/11; Case C-573/15, *Oxycure Belgium*.

¹⁶⁰³ Case C-201/18, *Mydibel*.

¹⁶⁰⁴ Compare with Case C-234/11, *TETS Haskovo*, in which the Court held that the demolition of a building (on which VAT had been deducted) should not necessarily be seen as providing grounds for an adjustment: the replacement of old buildings with more modern buildings that fulfil the same purpose and, hence, are used for taxable output transactions, in no way breaks the direct link between, on the one hand, the input acquisition of the buildings at issue and, on the other, the economic activities subsequently carried out by the taxable person. The acquisition of the buildings at issue and their subsequent destruction with a view to modernizing them can, therefore, be regarded as a series of linked transactions for purposes of subsequent taxable transactions, in the same way as the acquisition of new buildings and their direct use.

¹⁶⁰⁵ Case C-182/20, *BE and DT*.

In *Vittamed technologies*,¹⁶⁰⁶ the CJEU made it clear that a taxable person is required to regularize the VAT deductions paid upstream and related to the acquisition of goods or services intended to produce investment goods where, as a result of the owner or sole shareholder of the taxable person deciding to put the latter into liquidation, as well as the removal of the taxable person from the register of persons subject to VAT being requested and achieved, the investment goods created have not been used in the context of taxed economic activities and never will be.

K. Obligations of Taxable Persons and Certain Non-Taxable Persons

1. Obligation to Pay

a. Main Rules

VAT is payable: by any taxable person making a taxable supply of goods or services;¹⁶⁰⁷ by any person making a taxable intra-EU acquisition of goods;¹⁶⁰⁸ on importation, by any person or persons designated or recognized as liable by the Member State of importation;¹⁶⁰⁹ where goods are covered by customs warehouses, warehouses other than customs warehouses and similar arrangements, by any person that causes the goods to cease to be covered by such arrangements;¹⁶¹⁰ and by any person that enters VAT on an invoice.¹⁶¹¹

¹⁶⁰⁶ Case C-293/21, *Vittamed technologies*.

¹⁶⁰⁷ VATD, Art. 193.

¹⁶⁰⁸ VATD, Art. 200.

¹⁶⁰⁹ VATD, Art. 201.

¹⁶¹⁰ VATD, Art. 202.

¹⁶¹¹ VATD, Art. 203. A taxable person that has not contested the inclusion, in a credit note serving as an invoice (i.e., a self-billing invoice), of an amount of VAT greater than that owed by reason of taxable transactions may be regarded as the person that has indicated that amount and is consequently liable to pay the amount shown (Case C-141/96, *Langhorst*). Also, the VAT entered by a person on an invoice is payable by it regardless of whether a taxable transaction actually exists; however, an amount referred to in error as VAT on an invoice or other document serving as an invoice, where the underlying supply is not subject to VAT, cannot be classified as VAT. Hence, the VATD does not preclude the reimbursement of such an amount by the Member State concerned (Joined Cases C-78/02 to 80/02, *Karageorgou and Others*; see also Case C-642/11, *Stroy trans*). In Case C-48/20, *P (Fuel Cards)*, the CJEU emphasized that the VAT indicated on an invoice is payable by the issuer of the invoice even in the absence of any actual taxable transaction since VATD, Art. 203 is intended to eliminate the risk of loss of tax revenue that the deduction right provided for by the Directive might entail. In Case C-235/21, *Raiffeisen Leasing*, the CJEU held that VATD, Art. 203 must be interpreted as meaning that a contractual (in the case at hand: a sale-and-lease back) agreement, whose conclusion was not followed by the issue of an invoice by the parties, may be regarded as an invoice within the meaning of that provision, where the contractual agreement contains all the information necessary for the tax authorities of a Member State to be able to establish whether the substantive conditions for the right to deduct VAT are fulfilled. The risk of loss of tax revenue, which, as noted, is the objective of VATD, Art. 203, may be avoided where the tax authorities have the information necessary to establish whether the substantive requirements for the right to deduct VAT have been met, irrespective of whether the VAT is indicated in a document entitled "invoice" or in another document, such as a contractual agreement concluded by the parties. See also Case C-378/21, *Finanzamt Österreich (TVA facturée par erreur à des consommateurs finals)*, in which the CJEU held that VATD, Art. 203 must be interpreted as meaning that a taxable person that has supplied a service and has stated on the invoice an amount of VAT calculated based on an incorrect rate is not liable, under that provision, for the part of the VAT invoiced incorrectly if there is no risk of loss of tax revenue on the grounds that the recipients of the service are exclusively final consumers who do not have a right to deduct input VAT.

With effect from July 1, 2028, Council Directive (EU) 2025/1539 of July 18, 2025¹⁶¹² replaces the rule referred to above in accordance with which VAT is payable by any person or persons designated or recognized as liable by the Member State of importation with the following measures:

(i) On importation, VAT will be payable by any person or persons designated or recognized as liable by the Member State of importation.

(ii) There is an exception to the general rule where the supplier or the deemed supplier, under Article 14a(1) of the VATD (see XVII.D.1.a.(2), above), makes a distance sales of goods imported from third territories or third countries that would be eligible for the IOSS special scheme¹⁶¹³ (see XVII.L.6.d., below). In this case, the supplier or deemed supplier will be the person liable to pay the import VAT.

(iii) There is another exception where the supplier or the deemed supplier is not established in the European Union but in a third country with which neither the Union nor the Member State of importation has concluded an agreement on mutual assistance that is similar in scope to the VACR and Regulation (EU) No. 904/2010 (see XVII.N.1., below). In this case, the supplier or deemed supplier must appoint a tax representative in the Member State of importation to be the person liable for the payment of import VAT.

(iv) Where the person(s) liable for the payment of import VAT fail(s) to fulfil its/their tax obligations, a Member State may allow the customer to pay the import VAT due to prevent goods from being held up.

(v) Where a taxable person is required to appoint a tax representative, the tax representative will be the person liable for the payment of VAT on distance sales of goods imported from third territories or third countries that would be eligible for the IOSS scheme.

(vi) The existing “special arrangements for the declaration and payment of import VAT” (Chapter 7 of the VATD) will be deleted.

Overall, these measures are aimed at encouraging the use of the IOSS scheme, as non-EU traders or platforms that do not currently use it will otherwise have to register in each EU Member State in which they sell goods.

b. Reverse Charge Mechanism

As an alternative, however, in the case of B2B supplies made by a taxable person that is not established in the Member State in which the VAT is due, a Member State may (or must — see below) provide that the person liable for the payment of VAT is the person to which the goods or services are supplied (the “reverse charge mechanism”).¹⁶¹⁴ For this purpose, a tax-

able person that has a fixed establishment within the territory of the Member State in which the tax is due is regarded as a taxable person that is not established within that Member State when the following criteria are satisfied: (i) the person makes a taxable supply of goods or of services within the territory of that Member State; and (ii) an establishment that the supplier has within the territory of that Member State does not intervene in the supply.¹⁶¹⁵

Under the reverse charge mechanism, which was introduced with a view essentially to combating VAT fraud (such as VAT missing trader intra-EU fraud or carousel fraud¹⁶¹⁶), supplies are in effect zero-rated and business customers are liable for correctly assessing and spontaneously remitting the correct amount of tax due on their acquisitions to their own tax administration via periodic returns.

The reverse charge mechanism is mandatory for B2B supplies of electricity and gas,¹⁶¹⁷ B2B supplies of services,¹⁶¹⁸ cases of triangulation,¹⁶¹⁹ and specific transactions (under the special

national legislation under which the reverse charge mechanism does not apply to a taxable person that had neither applied for nor obtained on its own initiative its registration for VAT purposes before carrying out the taxable transactions concerned.

¹⁶¹⁵ VATD, Art. 192a. See also VAT Implementing Regulation, Arts. 53–54: there is intervention where the fixed establishment is used for transactions inherent in the fulfillment of the taxable supply of goods or services without the intervention constituting a separate supply. Where the resources of the fixed establishment are used only for administrative support tasks such as accounting, invoicing and the collection of debt claims, they are not regarded as being used for the fulfillment of the supply of goods or services.

¹⁶¹⁶ The two main forms of Missing Trader Intra-community (MTIC) fraud are carousel fraud and acquisition fraud. MTIC carousel fraud is carried out with the aim of submitting a fraudulent VAT refund claim, or sometimes to reduce the amount of VAT that a trader pays to the VAT administration. Goods are typically imported from another EU Member State and then sold through a chain of contrived transactions before being re-exported, also VAT-free. The first trader in the domestic fraudulent supply chain is the missing trader, which acquires the goods zero-rated for VAT purposes and makes a domestic VAT standard-rated sale. The missing trader goes missing without accounting for the VAT due to the VAT administration. The trader that eventually exports the goods fraudulently reclaims its input tax as a refund from the VAT authority. The intermediary traders in the supply chain that are placed between the missing trader and the exporter are sometimes referred to as buffers. The buffers typically buy and sell VAT standard-rated goods making minimal profit and consequently make a minimal payment of VAT to the tax administration. MTIC acquisition fraud refers to the situation in which a VAT-registered (missing) trader acquires goods VAT-free from another Member State, charging VAT on their onward domestic sale to a buffer company, but then deliberately fails to account for the VAT due to the VAT administration. The buffer typically sells the goods to a domestic wholesaler or distributor. As in the case of carousel fraud, there may be a complex series of transactions within the supply chain. However, the operation of acquisition fraud requires a legitimate end customer for the goods, which may eventually be sold for retail consumption. In MTIC acquisition fraud, because the missing trader has no suitable premises, the goods may be delivered directly to the wholesaler or distributor while the missing trader receives the invoices for the goods.

¹⁶¹⁷ VATD, Art. 195.

¹⁶¹⁸ VATD, Art. 196.

¹⁶¹⁹ VATD, Art. 197(1). An exception applies where the taxable person that is not established in the Member State has appointed a fiscal representative in that State (VATD, Art. 197(2)). In Case C-247/21, *Luxury Trust Automobil*, the CJEU held that Party B could only apply the simplified triangulation scheme in cross-border supply chains of goods if the invoices issued by Party B to Party C stated that the reverse charge mechanism applied. Failure to include this statement on the invoice cannot be corrected (retroactively) by issuing a new invoice with the correct statement. If Party B did not state that the reverse charge mechanism applied on its invoice, the triangulation scheme cannot be applied, which increases the VAT compliance burden for Party B in cross-border chain supplies.

¹⁶¹² Council Directive (EU) 2025/1539 of July 18, 2025 amending Directive 2006/112/EC as regards the VAT rules relating to taxable persons who facilitate distance sales of imported goods, and the application of the special scheme for distance sales of goods imported from third territories or third countries and special arrangements for the declaration and payment of import VAT.

¹⁶¹³ Title XII, Chapter 6, Section 4 of the VATD.

¹⁶¹⁴ VATD, Art. 194. In Case C-146/21, *DGRFP București*, the CJEU made it clear that neither the VATD nor the principle of fiscal neutrality precludes

scheme) relating to investment gold between a taxable person that is a member of a regulated gold bullion market and another taxable person that is not a member of that market.¹⁶²⁰

The reverse charge mechanism is optional for: (i) the supply of construction work, including repair, cleaning, maintenance, alteration and demolition services in relation to immovable property, as well as the handing over of construction works regarded as a supply of goods; (ii) the supply of staff engaged in activities covered by (i); (iii) the supply of a building or parts of a building and of the land on which the building stands, where the supplier has opted for taxation of the supply; (iv) the supply of used material, used material that cannot be re-used in the same state, scrap, industrial and non-industrial waste, recyclable waste, part processed waste and certain goods and services, as listed in Annex VI to the VATD; (v) the supply of goods provided as security by one taxable person to another in execution of that security; (vi) the supply of goods following the cession of a reservation of ownership to an assignee and the exercising of that right by the assignee; and (vii) the supply of immovable property sold by a judgment debtor in a compulsory sale procedure.¹⁶²¹

Also, a Member State may, until December 31, 2026, provide that the person liable for the payment of VAT is a taxable person to which any of the following supplies are made:

- (i) The transfer of allowances to emit greenhouse gases as defined in Article 3 of Directive 2003/87/EC of the European Parliament and of the Council of October 13, 2003, establishing a scheme for greenhouse gas emission allowance trading within the Community, that are transferable in accordance with Article 12 of that Directive;
- (ii) The transfer of other units that may be used by operators for compliance with the same Directive;
- (iii) Supplies of mobile telephones, being devices made or adapted for use in connection with a licensed network and operated on specified frequencies, whether or not they have any other use;
- (iv) Supplies of integrated circuit devices such as microprocessors and central processing units in a state prior to integration into end-user products;
- (v) Supplies of gas and electricity to a taxable dealer;
- (vi) Supplies of gas and electricity certificates;
- (vii) Supplies of telecommunication services;
- (viii) Supplies of game consoles, tablet PCs and laptops;
- (ix) Supplies of cereals and industrial crops, including oil seeds and sugar beet, that are not normally used for final consumption in their unaltered state; and

(x) Supplies of raw and semi-finished metals, including precious metals that are not otherwise covered by Article 199(d) of the VATD (see above in previous paragraph at (iv)), the special arrangements for secondhand goods, works of art, collector's items and antiques, or the special scheme for investment gold.¹⁶²²

Recourse to the reverse charge mechanism may also be had within the context of sudden and massive VAT fraud liable to lead to considerable and irreparable financial losses (known as the "quick reaction mechanism").¹⁶²³

In the "reverse charge mechanism" cases referred to above (with the exception of transactions in investment gold), the Member State in which the VAT is due may allow a taxable person that is not established in that State and that is liable for the payment of VAT to appoint a tax representative as the person liable for the payment of the VAT. Furthermore, where the taxable transaction is carried out by a taxable person that is not established in the Member State in which the VAT is due and no legal instrument relating to mutual assistance exists with the country in which that taxable person is established or has its seat, that State may provide that the person liable for payment of VAT is to be a tax representative appointed by the non-established taxable person. However, a Member State may not use this option in relation to a non-established taxable person that has opted for the special scheme for electronically supplied services.¹⁶²⁴

Finally, Member States may provide that a person other than the person liable for the payment of VAT is to be held jointly and severally liable for the payment of VAT.¹⁶²⁵ According to the CJEU, Member States are allowed to make a person jointly and severally liable for the payment of VAT if, at the time of supply, that person knew or had reasonable grounds for suspecting that the VAT payable with respect to that supply, or any previous or subsequent supply, would go unpaid, and to rely on presumptions in that regard. However, such presumptions may not be formulated in such a way as to make it practically impossible or excessively difficult for the taxable person to rebut them with evidence to the contrary.¹⁶²⁶ In other words, Member States must respect the general principles of law that form part of the EU legal order, which include, in particular, the principles of legal certainty and proportionality. Such a system of strict joint and several liability consequently, goes beyond what is necessary to preserve the public exchequer's rights.¹⁶²⁷

Under the VAT in the Digital Age (ViDA) Package, formally adopted by the Council on March 11, 2025 (see, XVII.O., below), Member States are required to implement a reverse charge mechanism for all B2B supplies of goods and services where the supplier is not established and VAT registered in the

¹⁶²⁰ VATD, Art. 198(1).

¹⁶²¹ VATD, Art. 199. As regards (vii), the CJEU has specified that the term "compulsory sale procedure" not only covers a sale of immovable property by a judgment debtor made in the course of the liquidation of the debtor's assets but also a sale made in the course of insolvency proceedings occurring before such liquidation, provided the sale is necessary either to settle creditors' claims or to enable the debtor to re-establish its economic or professional activities (Case C-125/12, *Promociones y Construcciones BJ* 200).

¹⁶²² VATD, Art. 199a, points (c) to (j) were inserted by Council Directive 2013/43/EU with the aim of curbing certain types of VAT fraud, in particular, VAT missing trader intra-EU carousel fraud (see above).

¹⁶²³ VATD, Art. 199b (as inserted by Council Directive 2013/42/EU).

¹⁶²⁴ VATD, Art. 204(1).

¹⁶²⁵ VATD, Art. 205.

¹⁶²⁶ Case C-384/04, *Federation of Technological Industries*; see also Joined Cases C-354/03, C-355/03 and C-484/03, *Optigen and Others*.

¹⁶²⁷ Case C-499/10, *Vlaamse Oliemaatschappij* (the case concerned a Belgian tax provision imposing unconditional joint and several liability on an authorized warehouse keeper, even though the warehouse keeper was acting in good faith and no fault or negligence was imputable to him).

EU Member State where VAT is due, and the recipient is identified for VAT in that Member State (new Article 194 (1) (a) of the VATD). Supplies of goods under the margin scheme are not subject to the reverse charge rule (new Article 194(2) of the VATD). Member States may also provide, under the conditions which they lay down, that the recipient of a supply is liable for the payment of VAT if the supplier is not established in the Member State in which VAT is due, regardless of the status of the customer (new Article 194 (1) (b) of the VATD). These rules become applicable as from July 1, 2028.

c. Payment Arrangements

Any taxable person liable for the payment of VAT must pay the net amount of the VAT when submitting a VAT return. Member States may, however, set a different date for payment of that amount or may require interim payments to be made.¹⁶²⁸

In the case of the importation of goods by taxable persons or certain categories of such persons, or by persons liable for the payment of VAT or certain categories of such persons, Member States may provide that the VAT due by reason of the importation need not be paid at the time of importation, on condition that it is entered as such in the periodic VAT return (this is known as the “postponed accounting system” (PAS)). Member States may condition the deferral of payment on the production of a certificate, provided the conditions for obtaining such a certificate respect the principle of fiscal neutrality.¹⁶²⁹

Member States may release taxable persons from paying the VAT due where the amount is insignificant.¹⁶³⁰

The provisions of the VATD and the principles of fiscal neutrality, effectiveness and proportionality must be interpreted as precluding national legislation or a national administrative practice from preventing a taxable person that has carried out transactions that subsequently proved to be covered by the reverse charge mechanism for VAT from correcting the invoices relating to those transactions and relying on them by correcting an earlier tax return or submitting a new tax return taking account of the correction thus made, with a view to obtaining a refund of the VAT improperly invoiced and paid by that taxable person, on the grounds that the period with respect to which those transactions were carried out had already been the subject of a tax inspection at the end of which the competent tax authority had issued a tax assessment that, not having been contested by that taxable person, had become final.¹⁶³¹

2. Identification

Every taxable person must state when its activity as a taxable person commences, changes or ceases.¹⁶³² On the other hand, every taxable person or non-taxable legal person that makes intra-EU acquisitions of goods that are not subject to VAT must state that it makes such acquisitions if the conditions for not making such transactions subject to VAT cease to be fulfilled.¹⁶³³

A Member State is to take the measures necessary to ensure that the following persons are identified by means of individual numbers: (i) every taxable person that, within the State’s respective territory, makes supplies of goods or services with respect to which VAT is deductible, other than supplies of goods or services with respect to which VAT is payable solely by the customer or the person for which the goods or services are intended under the reverse charge mechanism; (ii) every taxable person or nontaxable legal person that makes intra-EU acquisitions of goods subject to VAT and every taxable person or non-taxable legal person that exercises the option of having their intra-EU acquisitions subject to VAT; (iii) every taxable person that, within the State’s respective territory, makes intra-EU acquisitions of goods for purposes of transactions that relate to any economic activities referred to in the second subparagraph of Article 9(1) of the VATD (see XVII.C., above) and that are carried on outside that territory; (iv) every taxable person that, within the State’s respective territory, receives services with respect to which it is liable to pay VAT under the reverse charge mechanism; and (v) every taxable person established within the State’s respective territory that supplies services within the territory of another Member State with respect to which VAT is payable solely by the recipient under the reverse charge mechanism.¹⁶³⁴ Member States need not identify certain taxable persons that carry out transactions on an occasional basis only.¹⁶³⁵

Each individual VAT identification number has a prefix under ISO code 3166 — alpha 2 — that allows the Member State of issue to be identified.¹⁶³⁶

According to the CJEU, the first subparagraph of Article 213(1) and Article 273 of the VATD preclude national legislation that allows the competent tax authority to remove a taxable person from the VAT register on the grounds of a failure to comply with VAT obligations, without that tax authority analyzing the nature of the infringements committed and the conduct of the taxable person at issue. In other words, the removal of a taxable person from the VAT register solely on formal grounds without considering the nature of the infringements or the overall conduct of the taxable person is not allowed.¹⁶³⁷

3. Invoicing

The VAT invoicing rules set out in Articles 217 to 250 of the VATD are derived from Council Directive 2010/45/EU of July 13, 2010 amending the VATD as regards the rules on invoicing (which had to be implemented by January 1, 2013).

Member States must accept documents or messages on paper or in electronic form as invoices if they meet the requirements laid down in the VATD rules on invoicing.¹⁶³⁸ Any document or message that amends and refers specifically and unambiguously to an initial invoice is to be treated as an invoice.¹⁶³⁹

Every taxable person must ensure that an invoice is issued with respect to the following, either by itself or by its customer or, in the taxable person’s name and on its behalf, by a third

¹⁶²⁸ VATD, Art. 206.

¹⁶²⁹ Case C-79/12, *SC Mora*.

¹⁶³⁰ VATD, Art. 212.

¹⁶³¹ Case C-835/18, *Terracult*.

¹⁶³² VATD, Art. 213(1).

¹⁶³³ VATD, Art. 213(2).

¹⁶³⁴ VATD, Art. 214(1).

¹⁶³⁵ VATD, Art. 214(2).

¹⁶³⁶ VATD, Art. 215.

¹⁶³⁷ Case C-164/24, *Cityland*.

¹⁶³⁸ VATD, Art. 218.

¹⁶³⁹ VATD, Art. 219.

party: (i) supplies of goods or services it has made to another taxable person or to a non-taxable legal person; (ii) supplies of goods subject to the distance selling rules; (iii) exempt intra-EU supplies of goods; (iv) any payment on account made to it before a supply of goods referred to above in (i) or (ii) was made; and (v) any payment on account made to it by another taxable person or a non-taxable legal person before a supply of services was completed.

To provide legal certainty for businesses regarding their invoicing obligations, the VATD specifies which Member State's invoicing rules are applicable.¹⁶⁴⁰ In summary, the applicable rules are those of the Member State in which the supply of goods or services is made or deemed to be made, unless the supply of goods or services is made under the reverse charge mechanism, in which case invoicing is subject to the rules applying in the Member State in which the supplier has established its business or has a fixed establishment from which the supply is made or, in the absence of such a place of establishment or fixed establishment, the Member State in which the supplier has its permanent address or usually resides. Where the customer issues the invoice (self-billing),¹⁶⁴¹ the applicable rules are those of the Member State in which the customer is established if the customer is liable to pay the VAT.

Member States are obliged to allow taxable persons to issue a simplified invoice where: (i) the amount of the invoice is 100 euros or less or its equivalent in the relevant national currency; or (ii) the invoice issued is a document or message treated as an invoice under Article 219 of the VATD (see above).¹⁶⁴² However, a simplified invoice is not allowed with regard to a supply of goods subject to the distance selling rules or an intra-EU supply of goods or services.¹⁶⁴³

In the case of an intra-EU supply of goods or a supply of services with respect to which VAT is payable by the customer under the reverse charge mechanism, an invoice must be issued no later than the 15th day of the month following that in which the chargeable event occurs. In the case of other supplies of goods or services, Member States may impose time limits on taxable persons for the issue of invoices.¹⁶⁴⁴

Rules on the contents of full and simplified invoices are set out in Articles 226¹⁶⁴⁵ to 230 of the VATD. Member States may not require invoices to be signed.¹⁶⁴⁶ Paper invoices and electronic invoices are to be treated equally.

4. Accounting

Taxable persons must keep accounts in sufficient detail for VAT to be applied and its application checked by the tax authorities.¹⁶⁴⁷

In addition, every taxable person must ensure that copies of the invoices issued by itself, by its customers or, in the taxable person's name and on its behalf, by third parties, and all the invoices that it has received are stored.¹⁶⁴⁸ The taxable person may decide the place of storage of all invoices provided it makes the invoices or information it is required to store available to the competent authorities without undue delay whenever they so request. A Member State may require taxable persons established in its territory to notify it of the place of storage if that place is outside its territory.¹⁶⁴⁹ Each Member State is to determine the period for which taxable persons must ensure the storage of invoices relating to the supply of goods or services in its territory and invoices received by taxable persons established in its territory.¹⁶⁵⁰

Account-keeping obligations extend to taxable person facilitating, through the use of an electronic interface such as a marketplace, platform or portal or similar means, the supply of goods or services to a non-taxable person within the European Union in accordance with the provisions of Title V of the VATD,¹⁶⁵¹ to a taxable person transferring goods under a call-off stock arrangement, (see XVII.D.1.a.(4), above)¹⁶⁵² or to a payment service provider.¹⁶⁵³

5. Returns

A taxable person must submit a VAT return¹⁶⁵⁴ setting out all the information needed to calculate the VAT chargeable and the deductions to be made including, to the extent necessary for the establishment of the basis of assessment, the total value of the transactions relating to such VAT and deductions and the value of any exempt transactions.¹⁶⁵⁵ In addition, a VAT return

¹⁶⁴⁸ VATD, Art. 244.

¹⁶⁴⁹ VATD, Art. 245.

¹⁶⁵⁰ VATD, Art. 247(1).

¹⁶⁵¹ VATD, Art. 242a, introduced by Council Directive (EU) 2017/2455 of December 5, 2017 amending Directive 2006/112/EC as regards the harmonization and simplification of certain rules in the value added tax system for the taxation of trade between Member States.

¹⁶⁵² VATD, Art. 243(3), introduced by Council Directive (EU) 2018/1910 of December 4, 2018 amending Directive 2006/112/EC as regards the harmonization and simplification of certain rules in the value added tax system for the taxation of trade between Member States.

¹⁶⁵³ VATD, Art. 243a *et seq.*, introduced by Council Directive (EU) 2020/284 of February 18, 2020 amending Directive 2006/112/EC as regards introducing certain requirements for payment service providers. A "payment service provider" means any of the categories of payment service providers listed in points (a) to (d) of Art. 1(1) of Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC or a natural or legal person benefiting from an exemption in accordance with Art. 32 of that Directive. See also XVII.N.5.

¹⁶⁵⁴ On October 23, 2013, the Commission presented its proposal for a directive amending the VATD as regards a standard VAT return (COM (2013) 721 final). The idea behind a standard VAT declaration is to allow all businesses to provide standardized information to each Member State, submitted in a common, preferably electronic, format. In this way, a business submitting a VAT return in one Member State can easily complete and submit a VAT return in another Member State because the information and submission is standardized (Explanatory Memorandum, p. 5). According to the timetable laid down by the Commission, Member States were expected to bring into force the laws, regulations and administrative provisions necessary to comply with the (proposed) Directive by December 31, 2016, at the latest. However, the file was blocked in the Council as there was no political agreement and in its 2016 work program the Commission confirmed the withdrawal of the proposal.

¹⁶⁵⁵ VATD, Art. 250(1).

¹⁶⁴⁰ VATD, Art. 219a.

¹⁶⁴¹ See VATD, Art. 224 for further details on self-billing.

¹⁶⁴² VATD, Art. 220a(1).

¹⁶⁴³ VATD, Art. 220a(2).

¹⁶⁴⁴ VATD, Art. 222.

¹⁶⁴⁵ See, e.g., Case C-247/21, *Luxury Trust Automobile*: The omission, on an invoice, of the words "Reverse charge", required under VATD, Art. 226(11a), may not subsequently be corrected by adding a statement that that invoice relates to an intra-EU triangular transaction and that the tax liability is transferred to the person to whom the supply is made.

¹⁶⁴⁶ VATD, Art. 229.

¹⁶⁴⁷ VATD, Art. 242.

covering a particular tax period must contain the following: (i) the total value, exclusive of VAT, of intra-EU supplies of goods with respect to which VAT has become chargeable during that period; (ii) the total value, exclusive of VAT, of supplies of goods under the distance selling rules made within the territory of another Member State, with respect to which VAT has become chargeable during that period, where the place where the dispatch or transportation of the goods began is situated in the Member State in which the return must be submitted; (iii) the total value, exclusive of VAT, of intra-EU acquisitions of goods, or transactions treated as such, made in the Member State in which the return must be submitted and with respect to which VAT has become chargeable during that period; (iv) the total value, exclusive of VAT, of supplies of goods under the distance selling rules made in the Member State in which the return must be submitted and with respect to which VAT has become chargeable during that period, where the place where the dispatch or transportation of the goods began is situated within the territory of another Member State; and (v) the total value, exclusive of VAT, of supplies of goods made in the Member State in which the return must be submitted and with respect to which the taxable person has been designated (under Article 197 of the VATD) as liable for the payment of VAT and with respect to which VAT has become chargeable during that period.¹⁶⁵⁶

VAT returns must be submitted by a deadline to be determined by each Member State. However, that deadline may not be more than two months after the end of each tax period. The tax period is generally to be set by each Member State at one month, two months or three months, but Member States may set different tax periods provided those periods do not exceed one year.¹⁶⁵⁷

6. “Recapitulative” Statements

A taxable person identified for VAT purposes is required to submit a “recapitulative” statement covering the following: (i) the acquirers identified for VAT purposes to which it has made intra-EU supplies of goods; (ii) the persons identified for VAT purposes to which it has supplied goods that were supplied to it by way of intra-EU acquisitions; and (iii) the taxable persons, and the non-taxable legal persons identified for VAT purposes, to which it has supplied services, other than services that are exempted from VAT in the Member State in which the transactions are taxable, and with respect to which the recipient is liable to pay the tax under the reverse charge mechanism.¹⁶⁵⁸

As regards goods dispatched or transported under call-off stock arrangements in accordance with the conditions set out in Article 17a of the VATD (see XVII.D.1.a.(4), above), taxable persons must submit information on the VAT identification number of the taxable persons for whom such goods are intended and on any change in the submitted information.¹⁶⁵⁹

The recapitulative statement must be drawn up for each calendar month within a period not exceeding one month and in accordance with procedures to be determined by the Member

States.¹⁶⁶⁰ However, in accordance with the conditions and limits that they may lay down, Member States may allow a taxable person to submit the recapitulative statement for each calendar quarter within a time limit not exceeding one month from the end of the quarter, where the total quarterly amount, excluding VAT, of the cross-border supplies of goods does not exceed (with respect to either the quarter concerned or any of the previous four quarters) 50,000 euros or its equivalent in the national currency concerned. This option ceases to be available after the end of the month during which the total value, excluding VAT, of the relevant supplies exceeds (with respect to the current quarter) 50,000 euros or its equivalent in the relevant national currency. In that case, a recapitulative statement must be drawn up for the month(s) that has (have) elapsed since the beginning of the quarter, within a time limit not exceeding one month.¹⁶⁶¹ In the case of supplies of services, Member States, in accordance with the conditions and limits that they may lay down, may allow taxable persons to submit recapitulative statements for each calendar quarter within a time limit not exceeding one month from the end of the quarter. In particular, Member States may require a taxable person that makes intra-EU supplies of both goods and services to submit the recapitulative statement on a monthly basis when its combined supplies exceed 50,000 euros with respect to the current quarter.¹⁶⁶²

The recapitulative statement must set out: (i) the VAT identification number of the taxable person in the Member State in which the recapitulative statement is submitted and under which the taxable person has made exempt intra-EU supplies of goods and taxable B2B supplies of services; (ii) the VAT identification number of the person acquiring the goods or receiving the services in a Member State other than that in which the recapitulative statement is submitted and under which the goods or services were supplied to it; (iii) the VAT identification number of the taxable person in the Member State in which the recapitulative statement is submitted and under which it has made a transfer to another Member State referred to in Article 138(2)(c) of the VATD (i.e., a supply of goods consisting of a transfer to another Member State that would have qualified for exemption had it been made on behalf of another taxable person), and the number by means of which the taxable person is identified in the Member State in which the dispatch or transportation ended; (iv) for each person that acquired goods or received services, the total value of the supplies of goods and supplies of services made by the taxable person; (v) with respect to supplies of goods consisting of transfers to another Member State referred to in Article 138(2)(c) (see above), the total value of the supplies, i.e., the purchase price or cost price determined in accordance with Article 76 of the VATD; and (vi) the amounts of adjustments made under Article 90 of the VATD, i.e., in the case of cancellation, refusal, or total or partial nonpayment.¹⁶⁶³

¹⁶⁵⁶ VATD, Art. 251.

¹⁶⁵⁷ VATD, Art. 252.

¹⁶⁵⁸ VATD, Art. 262.

¹⁶⁵⁹ VATD, Art. 262(2), one of the “quick fixes” introduced by Council Directive (EU) 2018/1910 of December 4, 2018.

¹⁶⁶⁰ VATD, Art. 263(1).

¹⁶⁶¹ VATD, Art. 263(1)(a).

¹⁶⁶² VATD, Art. 263(1)(c).

¹⁶⁶³ VATD, Art. 264(1).

7. Option for Member States to Impose Other Obligations

Member States may impose other obligations that they deem necessary to ensure the correct collection of VAT and to prevent evasion. This is subject to the requirements that domestic transactions and transactions carried out between Member States by taxable persons should be treated equally and that such obligations should not, in trade between Member States, give rise to formalities connected with the crossing of frontiers.¹⁶⁶⁴ However, this option may not be relied on to impose additional invoicing obligations over and above those laid down in the VATD rules on invoicing. Moreover, according to the CJEU, such “other obligations” should not have the effect of undermining the neutrality of VAT.¹⁶⁶⁵

Under these limitations, the CJEU has ruled that Article 273 does not preclude national legislation that has the effect that a director of an entity which has failed to notify the latter’s inability to pay remains jointly and severally liable for the payment of a value added tax debt.¹⁶⁶⁶

L. Special Schemes

The VATD contains six special schemes, for: (i) small enterprises (Articles 281 to 294 of the VATD); (ii) farmers (Articles 295 to 305 of the VATD); (iii) travel agents (Articles 306

to 310 of the VATD); (iv) secondhand goods, works of art, collectors’ items and antiques (Articles 311 to 343 of the VATD); (v) investment gold (Articles 344 to 356 of the VATD); and (vi) non-established persons supplying electronic services to non-taxable persons (Articles 357–369 of the VATD).

1. Special Scheme for Small Enterprises

Broadly, the special scheme for small enterprises is primarily based on the exemption from VAT registration that depends on registration thresholds. It also allows gradual relief in the case of certain countries and a flat rate deduction of input VAT for certain types of activities. Under the scheme, a small enterprise is relieved of the heavy administrative and compliance burdens of VAT.

Member States that might encounter difficulties in applying the normal VAT arrangements to small enterprises, by reason of the activities or structure of such enterprises, may, subject to such conditions and limits as they may set, apply simplified procedures, such as flat-rate schemes, for charging and collecting VAT, provided the procedures do not lead to a reduction of VAT.¹⁶⁶⁷

Under Articles 284 to 286 of the VATD, the nine Member States that formed the European Union when the previous Sixth Directive was adopted (on May 17, 1977) are allowed to retain the exemptions applicable to small businesses prior to the entry into force of that Directive. Member States that at that time: (i) granted an exemption to taxable persons whose annual turnover was less than 5,000 euros are allowed to increase the threshold by up to 5,000 euros; (ii) had not made use of this option, are allowed to grant an exemption to taxable persons whose annual turnover is 5,000 euros or less; and (iii) applied an exemption to taxable persons whose annual turnover was 5,000 euros or less, are allowed to increase the threshold to maintain the value of the exemption in real terms. In the case of the 19 Member States that have acceded to the European Union since 1980, Article 287 of the VATD provides for ceilings ranging from 10,000 euros to 37,000 euros up to which those States may exempt small businesses from VAT.

The turnover that serves as a reference for purposes of the exemption consists of the amount, exclusive of VAT, of supplies of goods and services to the extent they are taxed (including by way of zero-rating), real property transactions, financial services transactions and insurance transactions, unless such transactions are merely ancillary to the business of the small enterprise concerned. Disposals of tangible or intangible capital assets of an enterprise are not taken into account for purposes of calculating turnover.¹⁶⁶⁸

The exemption applies to supplies of goods and services made by small businesses established within the Member State concerned, but there are certain transactions that a Member State may exclude from the exemption¹⁶⁶⁹ and others that it must exclude, i.e.: (i) transactions carried out on an occasional basis; (ii) intra-EU supplies of new means of transport; and (iii) supplies of goods or services made by a taxable person that is not established in the State in which the VAT is due.¹⁶⁷⁰

¹⁶⁶⁴ VATD, Art. 273. See also Case C-524/15, *Menci*, in which the CJEU held that Charter of Fundamental Rights of the European Union, Art. 50 must be interpreted as not precluding national legislation in accordance with which criminal proceedings may be brought against a person for failing to pay VAT due within the time limits stipulated by law, even though that person has already been made subject, in relation to the same acts, to a final administrative penalty of a criminal nature for the purposes of Charter, Art. 50. Such legislation must: (i) pursue an objective of general interest that is such as to justify such a duplication of proceedings and penalties, namely combating VAT offences, it being necessary for those proceedings and penalties to pursue additional objectives; (ii) contain rules ensuring coordination that limits to what is strictly necessary the additional disadvantage that results, for the persons concerned, from a duplication of proceedings; and (iii) provide for rules that make it possible to ensure that the severity of all penalties imposed is limited to what is strictly necessary in relation to the seriousness of the offence concerned. See also Case C-537/16, *Garlsson Real Estate and Others* and Opinion of Advocate General Campos Sanchez-Bordona in Case C-570/20, *BV v. Direction departementale des finances publiques de la Haute-Savoie*, concluding that Charter, Art. 50 does not preclude national legislation that permits the duplication of administrative and criminal proceedings and penalties in situations defined based on clear and precise criteria laid down by law and properly defined by case law. Nonetheless, Charter, Art. 50 does preclude national legislation that does not make it possible to ensure the required proportionality between the seriousness of the offence on the one hand, and the severity of all the combined penalties, on the other. In Case C-570/20, *BV*, the CJEU went on to make it clear that the fundamental right guaranteed by Charter, Art. 50, read in conjunction with Charter, Art. 52(1), must be interpreted as meaning that it: (i) does not preclude the limitation of the duplication of proceedings and penalties of a criminal nature in the event of fraudulent concealment or omissions from a return relating to VAT provided for by national legislation to the most serious cases being based only on settled case-law interpreting restrictively the legal provisions laying down the conditions for the application of that duplication, provided it is reasonably foreseeable, when the offence is committed, that the offence is liable to be the subject of a duplication of proceedings and penalties of a criminal nature; but (ii) does preclude national legislation that does not ensure, in the case of the combination of a financial penalty and a custodial sentence, by means of clear and precise rules, where necessary as interpreted by the national courts, that all the penalties imposed do not exceed the seriousness of the offence identified.

¹⁶⁶⁵ Case C-146/05, *Albert Collée*.

¹⁶⁶⁶ Case C-613/23, *Herdijk*.

¹⁶⁶⁷ VATD, Art. 281. See also Case C-128/05, *Commission v. Austria*.

¹⁶⁶⁸ VATD, Art. 288.

¹⁶⁶⁹ VATD, Art. 283(2).

¹⁶⁷⁰ VATD, Art. 283(1).

Taxable persons exempt from VAT are not entitled to deduct VAT and may not show the VAT on their invoices.¹⁶⁷¹ They may opt either for the normal VAT arrangements or for the simplified procedures, in which case they are entitled to any graduated tax relief provided for under national legislation.¹⁶⁷²

2. Common Flat-Rate Scheme for Farmers

Where the application to farmers of the normal VAT arrangements, or the special scheme for small enterprises, is likely to give rise to difficulties, Member States may apply to farmers a flat-rate scheme designed to offset the VAT charged on purchases of goods and services made by them.¹⁶⁷³

Under the scheme, supplies made by farmers (as defined in Annexes VII and VIII to the VATD) are exempt but the farmers are compensated with a flat rate to offset the VAT charged to them on inputs. This is achieved by way of flat-rate compensation percentages that are fixed by the Member States¹⁶⁷⁴ and applied to a qualifying farmer's turnover.¹⁶⁷⁵ Percentages are calculated based on macro-economic statistics for flat-rate farmers alone for the preceding three years.¹⁶⁷⁶

The flat-rate compensation percentages may not have the effect of obtaining for flat-rate farmers refunds greater than the input VAT charged.¹⁶⁷⁷

The common flat-rate scheme applies only to the supply of agricultural products and agricultural services; other operations carried out by flat-rate farmers thus remain subject to the general scheme under the VATD.¹⁶⁷⁸

3. Special Scheme for Travel Agents

The Special Scheme for Travel Agents, also known as the Tour Operators' Margin Scheme (TOMS) applies to travel agents, including tour operators, that deal with customers in their own name and that, without material alteration, buy in and resell travel, hotel, holiday and other related services to travelers. TOMS allows such an operator to calculate the VAT due on just the value that it adds to transactions, i.e., the margin made on its supplies (i.e., the difference between the price charged to the "traveler" exclusive of VAT and the amount paid on supplies bought from suppliers inclusive of VAT). Such a single service is taxable in the Member State in which the travel agent has established its business or has a fixed establishment (from which the travel agent has provided the ser-

vices). The scheme was introduced as a trade facilitation measure, with the objectives of simplifying the rules applicable to tour operators in relation to VAT and ensuring that VAT revenue from travel services is in part allocated where the services are enjoyed and in part where the tour operator is established.

According to the CJEU, TOMS encompasses travel packages sold to all customers, including companies that resell such packages to the public (the "customer approach"), and not only travel packages sold to the actual traveler (the "traveler approach") as was argued by the Commission.¹⁶⁷⁹ Also, the special scheme must be applied not only to services provided to private final consumers but also to services provided to taxable traders; hence, it is not open to the Member States to restrict the application of the scheme solely to the former category.¹⁶⁸⁰

An abundant body of case law has emerged with respect to the conditions for the application of this special regime, most of the litigation centering around the concepts of "travel agent"/"tour operator,"¹⁶⁸¹ "single service,"¹⁶⁸² "place of establishment"¹⁶⁸³ and "margin."¹⁶⁸⁴

Since 2020, the Commission has been conducting work on the expediency of TOMS: a roadmap setting out the scope and purpose of the evaluation of TOMS was published on February 4, 2020, followed by a public consultation launched on May 25, 2020, the publication of a Staff Working Document Evaluation on February 17, 2021, and an October 5, 2022 Working Paper prepared by the TAXUD Group on the Future of VAT (the "2022 Working Paper").¹⁶⁸⁵

The 2022 Working Paper concludes that there is a need to reconsider the overall VAT regime applicable to travel and tourism in a comprehensive manner.¹⁶⁸⁶ Overall, the VAT rules applicable to the travel and tourism sectors are not appropriate for the digital marketing of travel services. Digital technologies have radically transformed the sector, creating new business models (for example, online travel platforms and digital refund systems) that both pose challenges and offer opportunities for tax administrations and businesses, such as new possibilities for facilitating VAT compliance. According to the 2022 Working Paper, the main inconsistencies uncovered by the provisional analysis can be grouped into the following four areas where it is worth considering legal intervention: (i) the scope of the special scheme; (ii) the place of supply rule; (iii) the definition of concepts; and (iv) the margin calculation (Article 308 of the VATD, as interpreted by the CJEU, requires the margin to be calculated on a per transaction basis).

Against this backdrop, the 2022 Working Paper formulates a number of options for addressing these inconsistencies, as follows:

¹⁶⁷¹ VATD, Art. 289.

¹⁶⁷² VATD, Art. 290.

¹⁶⁷³ VATD, Art. 296(1). According to the CJEU, the application of the common flat-rate scheme for farmers may be denied to multiple civil law partnerships regarded as independent undertakings that are taxable persons for VAT purposes and that cooperate with each other. The grounds for this were that a limited company, an association of persons made up of the limited company and members of the civil law partnerships in question, could not be subject to the scheme, on account of the size of their operations or their legal forms, even if those civil law partnerships did not belong to a category of producers excluded from the flat-rate scheme, insofar as they were, as a result of their links with the company or one of the associations, materially capable of assuming the administrative burden of the tasks arising from the application of the normal arrangements or the simplified scheme (Case C-340/15, *Christine Nigl and Others*).

¹⁶⁷⁴ VATD, Art. 297.

¹⁶⁷⁵ VATD, Art. 300.

¹⁶⁷⁶ VATD, Art. 298.

¹⁶⁷⁷ VATD, Art. 299.

¹⁶⁷⁸ Case C-321/02, *Detlev Harbs*; Case C-43/04, *Stadt Sundern*.

¹⁶⁷⁹ Cases C-189/11, C-193/11, C-236/11, C-269/11, C-293/11, C-296/11, C-309/11, C-450/11, *Commission v. Spain, Poland, Italy, Czech Republic, Greece, France, Finland, Portugal*.

¹⁶⁸⁰ Case C-189/11, *Commission v. Spain*.

¹⁶⁸¹ Case C-308/96, *Howden Court Hotel*.

¹⁶⁸² Case C-163/91, *Van Ginkel*; Case C-31/10, *Minerva Kulturreisen*; Case 557/11, *Kozak*.

¹⁶⁸³ Case C-260/95, *DFDS*.

¹⁶⁸⁴ Case C-94/97, *Madgett and Baldwin*; Case C-291/03, *My Travel*; Case C-149/01, *First Choice Holidays*.

¹⁶⁸⁵ taxud.c.1(2022)7683381 — Group on the Future of VAT GFV No 125.

¹⁶⁸⁶ See also Case C-108/22, *C.sp. zo.o*.

(i) Options as regards the scope of the scheme (Area A): (a) status quo: the scheme applies to all supplies of travel facilities, including B2B, wholesale, Meeting, Incentives, Conference and Events (MICE) and occasional services; (b) exclusion of wholesale supplies: the scheme applies only to supplies of travel facilities to travelers (both private and taxable business customers); (c) B2B optionality: travel agents may decide whether they apply the scheme to supplies of travel facilities to taxable persons, on a transaction-by-transaction basis; (d) exclusion of MICE: MICE services to taxable persons are excluded from the scheme unless the organization of the event concerned is ancillary to the provision of accommodation and transport; or (e) occasional supplies: supplies of travel facilities when they represent a marginal share of the supplier's turnover (for example, 1–5%) are excluded from the scheme.

(ii) Options as regards the place of supply (Area B): (a) status quo: travel facilities remain taxed at origin and the margins of non-EU travel agents are not taxed; (b) place of traveler's residence (only non-EU travel agents): the place of supply of travel facilities by non-EU travel agents becomes the country of residence of the travelers; the status quo remains for EU travel agents; (c) place of destination (only non-EU travel agents): the place of supply of travel facilities by non-EU travel agents becomes the country in which the travel takes place; status quo remains for EU travel agents; (e) place of traveler's residence (all travel agents): the place of supply of travel facilities by any travel agent (EU or non-EU) becomes the place of residence of the traveler; or (e) place of destination (all travel agents): the place of supply of travel facilities by any travel agent (EU or non-EU) becomes the place where the travel takes place.

(iii) Options as regards the definition of concepts (Area C) (each time subdivided into an approach 1 and an approach 2): (a) agent vs. principal: status quo: no definition introduced (approach 1) or introduction of a list of presumptive behaviors determining when the travel agent is a disclosed agent or principal (approach 2); (b) travel facilities (services and conditions): a travel facility consists of a bundle of services that includes at least two of the following: accommodation; passenger transport; and other travel services benefitting the traveler (approach 1) or a travel facility consists of a bundle of services that includes at least two touristic services listed in the Implementing Regulation (i.e., not requiring either accommodation or transport to be included) (approach 2); (c) MICE: status quo, i.e. MICE fall within the scope of the scheme if the event organization is supplied together with accommodation or transport (approach 1) or event organization is not considered a travel facility unless it is ancillary/marginal to the provision of transport or accommodation (approach 2); (d) single item: any service supplied as a single item is out of scope (approach 1) or accommodation supplied as a single item is covered by the scheme (approach 2); and (e) mixed supplies: the scheme only applies to bought-in services; inhouse services are not covered and must be invoiced separately (approach 1) or mixed supplies are cov-

ered; the margin is apportioned based on market value or, if not available, on a cost-basis (approach 2).

(iv) Options as regards margin calculation (Area D): (a) status quo: margin is calculated per transaction and VAT is chargeable on receipt of payments on account; (b) mandatory global margin: margins must be calculated via a global approach annually with ex-post adjustments; VAT becomes chargeable on the date of commencement of the travel facility; or (c) optional global margin: travel agents can decide whether to use a global or transaction-by-transaction approach to the calculation of margins; VAT becomes chargeable on the date of the commencement of the travel facility.

The 2022 Working Paper is intended to serve as an economic study providing data and an evidence-based analysis to feed into the Impact Assessment underpinning a potential Commission proposal. It is now up to the Commission to (further) assess the possible need for a legislative proposal that would focus on three interlinked sets of provisions of the VATD: (i) the special VAT scheme for travel agents (Articles 306–310); (ii) the VAT rules on passenger transport (Articles 48 and 148); and (iii) the VAT exemption for the supply of goods to non-EU travelers (Articles 146, 147 and 158).

4. *Special Arrangements for Secondhand Goods, Works of Art, Collectors' Items and Antiques*

In the case of the supply of secondhand goods, works of art, collectors' items or antiques made by a taxable dealer, Member States must apply a special scheme for taxing the profit margin made by the dealer.¹⁶⁸⁷ A "taxable dealer" means any taxable person that, in the course of its economic activity and with a view to resale, purchases, applies for purposes of its business or imports secondhand goods, works of art, collectors' items or antiques, whether the taxable person is acting for itself or on behalf of another person pursuant to a contract under which commission is payable on purchase or sale.¹⁶⁸⁸ "Secondhand goods" means movable tangible property that is suitable for further use as it is or after repair,¹⁶⁸⁹ other than works of art, collectors' items or antiques, and precious metals or precious stones as defined by the Member States. "Works of art" means the objects listed in Annex IX, Part A to the VATD. "Collectors' items" means the objects listed in Annex IX, Part B to the VATD. "Antiques" means the objects listed in Annex IX, Part C to the VATD.¹⁶⁹⁰

The margin scheme applies to the supply by a taxable dealer of secondhand goods, works of art, collectors' items or antiques where those goods have been supplied to it¹⁶⁹¹ within the

¹⁶⁸⁷ VATD, Art. 313(1).

¹⁶⁸⁸ VATD, Art. 311(1)(5). An undertaking that, in the normal course of its business, resells cars that it has purchased secondhand with a view to using them for purposes of its business of sale and leaseback and for which the resale is not, at the time of the purchase of the secondhand goods, the principal but only its secondary objective, ancillary to that of leasing, can be considered to be a "taxable dealer" (Case C-280/04, *Jyske Finans*).

¹⁶⁸⁹ Case C-320/02, *Förvaltnings AB Stenholmen* (an animal bought from a private individual (other than the breeder) that is sold on after training for a specific use may be considered to be secondhand goods).

¹⁶⁹⁰ VATD, Art. 311(1)(1)–(4).

¹⁶⁹¹ Where goods have been imported by the taxable dealer subject to the normal VAT scheme at the time of their importation, the existence of the right

European Union by: (i) a nontaxable person; (ii) another taxable person, to the extent the supply of goods by that other taxable person is exempt under Article 136 of the VATD; (iii) another taxable person, to the extent the supply of goods by that other taxable person is covered by the exemption for small enterprises and involves capital goods; or (iv) another taxable dealer, to the extent VAT has been applied to the supply of goods by that other taxable dealer in accordance with the margin scheme.¹⁶⁹²

The taxable amount with respect to a supply of goods is the profit margin made by the taxable dealer, less the amount of VAT relating to the profit margin. The profit margin is equal to the difference between the selling price charged by the taxable dealer for the goods and the purchase price.¹⁶⁹³ For this purpose, “selling price” means everything that constitutes the consideration obtained or to be obtained by the taxable dealer from the customer or from a third party, including subsidies directly linked to the transaction, taxes, duties, levies and charges and incidental expenses, such as commission, packaging, transport and insurance costs charged by the taxable dealer to the customer. The selling price does not include price reductions by way of discount for early payment, price discounts and rebates granted to the customer and obtained by the customer at the time of supply, or amounts received by the taxable person from the customer as repayment of expenditure incurred in the name and on behalf of the customer and entered in its books in a suspense account. “Purchase price” means everything that constitutes the consideration obtained or to be obtained from the taxable dealer by its supplier.¹⁶⁹⁴ In the case of the supply of works of art, collectors’ items or antiques that the taxable dealer has imported itself, the purchase price to be taken into account in calculating the profit margin is equal to the taxable amount on importation, plus the VAT due or paid on importation.¹⁶⁹⁵

Member States must grant a taxable dealer the right to opt for the application of the margin scheme to the supply of: (i) works of art, collectors’ items or antiques that the taxable dealer has imported itself; (ii) works of art supplied to the taxable dealer by the creator or the creator’s successors in title; and (iii) works of art supplied to the taxable dealer by a taxable person other than a taxable dealer where the reduced rate under Article 103 of the VATD (or the reduced rate for secondhand goods) has been applied to that supply.¹⁶⁹⁶

The supply of secondhand goods, works of art, collectors’ items or antiques subject to the margin scheme is exempt.¹⁶⁹⁷ To the extent goods are used for purposes of supplies made by it and subject to the margin scheme, the taxable dealer may not deduct from the VAT for which it is liable VAT due or paid

with respect to: (i) works of art, collectors’ items or antiques that it has imported itself; (ii) works of art that have been, or are to be, supplied to it by their creator or by the creator’s successors in title; or (iii) works of art that have been, or are to be, supplied to it by a taxable person other than a taxable dealer.¹⁶⁹⁸ Taxable persons may not deduct from the VAT for which they are liable VAT due or paid with respect to goods that have been, or are to be, supplied to them by a taxable dealer, to the extent the supply of those goods by the taxable dealer is subject to the margin scheme.¹⁶⁹⁹

A taxable dealer may apply the normal VAT arrangements to any supply covered by the margin scheme.¹⁷⁰⁰ Where the taxable dealer applies the normal VAT arrangements to the supply of a work of art, a collectors’ item or an antique that it has imported itself, it is entitled to deduct from the VAT for which it is liable the VAT due or paid on the import. Where the taxable dealer applies the normal VAT arrangements to the supply of a work of art supplied to it by its creator, or the creator’s successors in title, or by a taxable person other than a taxable dealer, the taxable dealer is entitled to deduct from the VAT for which it is liable the VAT due or paid with respect to the work of art supplied to it.¹⁷⁰¹ The right of deduction arises at the time when the VAT due on the supply with respect to which the taxable dealer opts for application of the normal VAT arrangements becomes chargeable.¹⁷⁰²

Where a taxable dealer applies both the normal VAT arrangements and the margin scheme, it must show the transactions falling under each of those arrangements in its accounts separately, in accordance with the rules laid down by the Member States.¹⁷⁰³

In the case of a sale by public auction, a Member State may apply special arrangements for the taxation of the profit margin made by the organizer of the sale with respect to the supply of secondhand goods, works of art, collectors’ items or antiques by that organizer, acting in his own name and on behalf of qualifying persons, pursuant to a contract under which a commission is payable on the sale of those goods by public auction.¹⁷⁰⁴ For this purpose, an “organizer of a sale by public auction” means any taxable person that, in the course of its economic activity, offers goods for sale by public auction with a view to handing them over to the highest bidder;¹⁷⁰⁵ and a “principal of an organizer of a sale by public auction” means any person that transmits goods to an organizer of a sale by public auction pursuant to a contract under which a commission is payable on a sale.¹⁷⁰⁶ The contract under which a commission is payable on a sale must provide that the organizer of the sale is to put up the goods for public auction in its own name but on behalf of its principal and that it is to hand over the goods, in its own name but on behalf of its principal, to the highest bidder at the public auction.¹⁷⁰⁷

to deduct precludes the likelihood of double taxation, so that, in such circumstances, there is no justification for excluding the application of the normal scheme in favor of the special margin regime; see Case C-203/10, *Auto Nikolovi*.

¹⁶⁹² VATD, Art. 314. According to the CJEU, this provision must be construed narrowly, meaning that the cases in which the special arrangement is to be applied must be considered to be exhaustively listed (Case C-160/11, *Bawaria Motors*).

¹⁶⁹³ VATD, Art. 315.

¹⁶⁹⁴ VATD, Art. 312.

¹⁶⁹⁵ VATD, Art. 317(1).

¹⁶⁹⁶ VATD, Art. 316(1).

¹⁶⁹⁷ VATD, Art. 321.

¹⁶⁹⁸ VATD, Art. 322.

¹⁶⁹⁹ VATD, Art. 323.

¹⁷⁰⁰ VATD, Art. 319.

¹⁷⁰¹ VATD, Art. 320(1).

¹⁷⁰² VATD, Art. 320(2).

¹⁷⁰³ VATD, Art. 324.

¹⁷⁰⁴ VATD, Arts. 333–341.

¹⁷⁰⁵ VATD, Art. 311(1)(6).

¹⁷⁰⁶ VATD, Art. 311(1)(7).

¹⁷⁰⁷ VATD, Art. 311(3).

5. *Special Scheme for Investment Gold*

For purposes of the special scheme for investment gold,¹⁷⁰⁸ the term “investment gold” refers to: (i) gold, in the form of a bar or a wafer of a weight accepted by the bullion markets (though Member States may exclude bars or wafers of 1 gram or less), of a purity equal to or greater than 995 thousandths, whether or not represented by securities; and (ii) gold coins of a purity equal to or greater than 900 thousandths and minted after 1800 that are or have been legal tender in the country of origin and are normally sold (other than for numismatic interest) at a price that does not exceed the open market value of the gold contained in the coins by more than 80%.¹⁷⁰⁹

Under the scheme, there is a compulsory VAT exemption for the supply, intra-EU acquisition and importation of investment gold, including investment gold represented by certificates for allocated or unallocated gold or gold traded on gold accounts, including, in particular, gold loans and swaps involving a right of ownership or claim with respect to investment gold, as well as transactions concerning investment gold involving futures and forward contracts leading to a transfer of a right of ownership or claim with respect to investment gold.¹⁷¹⁰ In addition, Member States must exempt from VAT the services of agents that act in the name and on behalf of another person, when they take part in the supply of investment gold for their principals.¹⁷¹¹

A taxation option is provided for producers of investment gold or transformers of gold into investment gold: Member States must allow taxable persons that produce investment gold or transform gold into investment gold the right to opt for the taxation of supplies of investment gold to another taxable person that would otherwise be exempt under the special scheme.¹⁷¹² In addition, Member States may allow taxable persons that, in the course of their economic activity, normally supply gold for industrial purposes, the right to opt for the taxation of supplies of gold bars or wafers to another taxable person that would otherwise be exempt under the special scheme (Member States may restrict the scope of this option).¹⁷¹³ In such cases, Member States must allow agents to opt for taxation of their services when they take part in the supply of investment gold for their principals.¹⁷¹⁴

A Member State may, after consulting the VAT Committee, apply VAT to specific transactions relating to investment gold that take place in that State between taxable persons that are members of a gold bullion market regulated by the State concerned or between such a taxable person and another tax-

able person that is not a member of that market (in which latter case, the reverse charge mechanism will be applicable). However, the Member State may not apply VAT to intra-EU supplies or exports of investment gold.¹⁷¹⁵ Member States that, based on the above, apply VAT to transactions between taxable persons that are members of a regulated gold bullion market are required, for purposes of simplification, to authorize the suspension of the VAT to be collected and to relieve taxable persons of the accounting requirements with respect to VAT (this is known as the “black box system”).¹⁷¹⁶

To prevent the investment gold tax exemption discussed above from affecting the deduction of VAT paid with respect to investment gold where a taxable person’s subsequent supply of investment gold is exempt, the taxable person is entitled to deduct the VAT due or paid with respect to: (i) investment gold supplied to it by a person that has exercised the right to opt for taxation; (ii) a supply to it, or an intra-EU acquisition or importation carried out by it, of gold other than investment gold that is subsequently transformed by it, or on its behalf, into investment gold; and (iii) services supplied to it consisting of a change in the form, weight or purity of gold including investment gold.¹⁷¹⁷

In addition, taxable persons that produce investment gold or transform gold into investment gold are entitled to deduct the VAT due or paid by them with respect to the supply, intra-EU acquisition or importation of goods or services linked to the production or transformation of that gold, as if the subsequent supply of the gold exempted under the special exemption scheme discussed above were taxed.¹⁷¹⁸

Member States must ensure that traders in investment gold, as a minimum requirement, keep accounts of all substantial transactions in investment gold and retain documents that enable the customers in such transactions to be identified. Traders must retain such information for a period of at least five years. Member States may also accept equivalent obligations under measures adopted pursuant to other EU legislation, such as Directive 2005/60/EC of the European Parliament and of the Council of October 26, 2005 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing (as amended), to comply with these accounting and document retention requirements.¹⁷¹⁹

6. *Special Schemes for Taxable Persons Supplying Services to Non-Taxable Persons or Making Distance Sales of Goods or Certain Domestic Supplies of Goods*

a. *General*

Introduced as of January 1, 2015, the VAT Mini One Stop Shop (MOSS) was a system through which providers of telecommunications, broadcasting and electronic (TBE) services could register in one Member State and make returns with

¹⁷⁰⁸ The VATD operative provisions originally derive from Council Directive 98/80/EC of October 12, 1998, introducing a special scheme for investment gold.

¹⁷⁰⁹ VATD, Art. 344(1). See the list of gold coins meeting the criteria established in Council Directive 2006/112/EC (special scheme for investment gold) — Valid for the year 2026: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=OJ:C_202505923. The coins included in the list are considered to satisfy the criteria in Art. 344 and will, therefore, be treated as investment gold in those Member States. As a result, their supply is exempt from VAT for the whole of the 2026 calendar year.

¹⁷¹⁰ VATD, Art. 346.

¹⁷¹¹ VATD, Art. 347.

¹⁷¹² VATD, Art. 348.

¹⁷¹³ VATD, Art. 349.

¹⁷¹⁴ VATD, Art. 350.

¹⁷¹⁵ VATD, Art. 352.

¹⁷¹⁶ VATD, Art. 353.

¹⁷¹⁷ VATD, Art. 354.

¹⁷¹⁸ VATD, Art. 355.

¹⁷¹⁹ VATD, Art. 356. 311(1)(1)–(4).

respect to all Member States to which they provide services.¹⁷²⁰ From July 1, 2021, the scope of the MOSS was expanded to include other services supplied on a business to consumer (B2C) basis, intra-EU distance sales of goods and some domestic supplies of goods. The MOSS system became the One Stop Shop (OSS).

The VAT OSS simplifies VAT obligations for businesses selling goods and services cross-border to final consumers in the European Union. Within the OSS, there are two schemes, the Non-Union scheme (see XVII.L.6.b., below) and the Union scheme (see XVII.L.6.c., below).

In addition, there is a special scheme for distance sales of goods imported from third territories or third countries, the Import One Stop Shop (IOSS)(see XVII.L.6.d., below).

The three schemes are commonly also jointly referred to as the EU VAT e-Commerce Package.

A fourth scheme has been added by the VAT in the Digital Age (ViDA) Package formally adopted by the Council on March 11, 2025, i.e. the special scheme for transfer of own goods (see, XVII.O.3., below).

b. Special Scheme for Services Supplied by Taxable Persons Not Established Within the European Union (“Non-Union scheme”)

The relevant provisions of the Non-Union scheme are set out in Articles 358a through 369 of the VATD and Articles 57a through 63c of the VAT Implementing Regulation.

For purposes of the Non-Union scheme, a “taxable person not established within the European Union” means a taxable person who has not established its business in the territory of the European Union and that has no fixed establishment¹⁷²¹ there. “Member State of identification” means the Member State that the taxable person not established within the European Union chooses to contact to state when its activity as a taxable person within the territory of the European Union commences in accordance with the provisions of this Special Scheme. “Member State of consumption” means the Member State in which the supply of services is deemed to take place under Chapter 3 of Title V of the VATD (place of supply of services — see XVII.E.4., above).¹⁷²²

The Non-Union scheme extends the scope of the former special scheme for TBE services supplied by taxable persons not established within the European Union to consumers (which entered into effect on January 1, 2015) to all services supplied to non-taxable persons in a Member State under the place-of-supply-of-services rules. The use of the Non-Union

scheme to declare and pay EU VAT on services supplied to final consumers across the European Union is optional.

Under the Non-Union scheme, which, as already noted, became effective on July 1, 2021, taxable persons not established in the European Union supplying services to non-taxable persons (consumers) in the European Union do not need to register for VAT in each Member State in which their supplies of services take place. Rather, the VAT due on such supplies can be declared and paid in one single Member State, i.e., the Member State of identification, via the OSS. For purposes of the OSS/Non-Union scheme, the Member State of identification is the State in which the taxable person not established in the European Union is registered to use the scheme, and in which it declares and pays the VAT due in the Member State(s) of consumption. The Non-Union scheme rules thus do not change the place of supply of the services involved, but only offer a simplified procedure for declaring and paying the VAT due in the Member States where such supplies are made. In other words, the VAT rules applicable to domestic supplies in the Member State of consumption apply to supplies under the OSS/Non-Union scheme, and not the VAT rules applicable to domestic supplies in the Member State of identification. It follows that the applicable VAT rate is the VAT rate applicable to the service in the Member State to which the service is supplied.

A taxable person not established within the European Union that is registered or obliged to register for VAT purposes in one of the Member States for supplies other than B2C services can still opt to use the Non-Union scheme for B2C supplies.

A non-EU supplier that opts to use the Non-Union scheme has to use the scheme to declare and pay VAT for all relevant B2C supplies of services in the European Union. Examples of B2C supplies of services that may be reported under the Non-Union scheme include (the list is non-exhaustive): accommodation services provided by non-established taxable persons; admission to cultural, artistic, sporting, scientific, educational, entertainment or similar events, such as fairs and exhibitions; transport services; services of valuation and work on movable tangible property; ancillary transport activities such as loading, unloading, handling and similar activities; services connected to immovable property; the hiring of means of transport; and the supply of restaurant and catering services for consumption on board ships, aircraft or trains.

As already indicated, a taxable person (that has neither established its business nor has a fixed establishment in the European Union) can choose any Member State to be the Member State of identification. That Member State will allocate an individual VAT identification number to the taxable person (using the format EUxxxxxyyyz). This VAT identification number is not a VAT number for general use in that it can only be used to declare supplies falling under the Non-Union scheme.

Under the Non-Union scheme, a quarterly non-Union VAT return must be submitted electronically by the end of the month following the end of the tax period covered by the return. A VAT return must be submitted whether or not any supplies have been made during the quarter covered by the return. The VAT return is submitted to the VAT authorities of the Member State of identification for onward transmission to the relevant Member States of consumption. At the same time as the Non-Union scheme VAT return is submitted to the VAT

¹⁷²⁰ The Mini One Stop Shop (MOSS) allowed taxable persons supplying telecommunications, broadcasting and electronic (TBE) services to non-taxable persons in Member States in which they did not have an establishment to account for the VAT due on those supplies via a web-portal in the Member State in which they had an identification number. The scheme was optional and was introduced as a simplification measure following the change to the VAT place of supply rules, under which supplies take place in the Member State of the customer rather than the State of the supplier. The MOSS allowed such taxable persons to avoid registering in each Member State of consumption.

¹⁷²¹ For an establishment to qualify as a fixed establishment, it should have a sufficient degree of permanence and a suitable structure in terms of human and technical resources to receive and use or make the respective supplies. Simply having a VAT identification number does not, in itself, make an establishment a fixed establishment.

¹⁷²² VATD, Art. 358a.

authorities of the Member State of identification (by the end of the month following the end of the tax period covered by the return), the taxable person must remit all EU VAT payable to those authorities. The VAT return must include: (i) the taxable person's identification number (issued at registration) and, for every Member State of consumption in which services have been provided and in which VAT is due: (ii) the total value of supplies made covered by the non-Union scheme during the tax period, exclusive of VAT; (iii) the total amount broken down by rate of corresponding VAT; (iv) the applicable rates of VAT; and (v) the total VAT due with respect to the supplies. A correction can be made to a previously submitted Non-Union scheme VAT return up to three years after the initial return was made. However, an amendment to the original return is not permitted in VAT OSS. Rather, the amendment must be made in a subsequent Non-Union scheme VAT return by completing the correction panel.

A taxable person registered for the Non-Union scheme must retain records as a requirement of using the scheme. The taxable person must keep records of all transactions covered by the scheme and the records must be detailed enough for the Member State of consumption to verify that the VAT return is correct. Details of the records to be retained are included in Article 63c(1) of the VAT Implementing Regulation. These records must be made available electronically at the request of the Revenue Commissioners or the Member State of consumption. The records are required to be retained for a period of 10 years from December 31 of the year in which the transaction was carried out.

Where supplies have been made using a currency other than the euro, the exchange rate to be used is that published by the European Central Bank on the last day of the calendar quarter to which the VAT return relates. If there is no publication on that date, the rate on the next day of publication is to be used.

The VAT Directive does not impose a mandatory invoicing obligation with respect to supplies of services to consumers in the European Union by taxable persons not established in the European Union. Nonetheless, their national legislation of a Member State may require an invoice for such supplies. Under the Non-Union scheme, the invoicing rules of the Member State of identification will then apply.

A taxable person making use of the Non-Union scheme is not entitled to deduct VAT incurred in a Member State via the Non-Union VAT return. Instead, the taxable person is to use the provisions of Council Directive 86/560/EEC i.e. the Thirteenth Directive (see XVII.J.3., above). A taxable person using the scheme that is obliged to be VAT-registered in a Member State for business activities not covered by the Non-Union scheme will deduct the VAT incurred in that Member State in relation to the activities covered by the Non-Union scheme in the normal VAT return submitted to the tax administration of that Member State.

A taxable person may de-register from the Non-Union scheme. A taxable person may also be removed from the scheme, especially if it persistently fails to comply with the rules of the scheme. A taxable person that is removed from the Non-Union scheme for persistent failure to comply with the rules of the scheme will be excluded from all special schemes (Union, Non-Union and IOSS) in any Member State for two years following the period during which the person was excluded.

A taxable person will be considered to have persistently failed to comply with the rules of the Non-Union scheme in (at least) the following cases (the list is non-exhaustive), i.e., where the taxable person has: (i) received reminders to submit a Non-Union VAT return for three return periods and an OSS VAT return has not been submitted within 10 days of the reminder being sent; (ii) received reminders to submit payment for three return periods and the full amount due has not been paid within 10 days of a reminder being sent, unless the amount outstanding for each return is less than 100; or (iii) failed to provide records electronically to the VAT authorities of the Member State of identification within one month of the issue by those authorities of a reminder to do.

It is possible for a taxable person to register for multiple schemes, depending on where that person has established its business and the supplies it makes. A taxable person that is registered for the Non-Union scheme with respect to services supplied on a B2C basis may also register for the Union scheme with respect of intra-EU distance sales of goods in the European Union and can also opt to register for the IOSS with respect to distance sales of goods imported from third territories or third countries.

Member States may not require a non-EU supplier to appoint a tax representative to be able to use the Non-Union scheme (Article 204 of the VATD), but a taxable person registered under the scheme is free to appoint one.

c. Special Scheme for Intra-European Union Distance Sales of Goods, for Supplies of Goods Within a Member State Facilitated by Electronic Interfaces and for Services Supplied by Taxable Persons Established Within the Community but Not in the Member State of Consumption ("Union scheme")

The relevant provisions of the Union scheme are set out in Articles 369a through 369k of the VATD and Articles 57a through 63c of the VAT Implementing Regulation.

For purposes of the Union scheme,¹⁷²³ a "taxable person not established in the Member State of consumption" means a taxable person that has established its business in the European Union or has a fixed establishment in the European Union but has not established its business and has no fixed establishment within the territory of the Member State of consumption.

The definition of "Member State of identification" distinguishes between the following situations: (i) the Member State of identification is the State in whose territory the taxable person has established its business or, if it has not established its business in the European Union, where it has a fixed establishment; (ii) where a taxable person has not established its business in the European Union but has more than one fixed establishment in the European Union, the Member State of identification is the State with a fixed establishment where the taxable person indicates that it will make use of this special scheme (the taxable person is bound by that decision for the calendar year concerned and the following two calendar years); and (iii) where a taxable person has not established its business in the European Union and has no fixed establishment in the European Union, the Member State of identification is the State in

¹⁷²³ VATD, Art. 369a.

which the dispatch or transport of the goods begins — where there is more than one State in which the dispatch or transport of the goods begins, the taxable person must indicate which of those States is the Member State of identification (the taxable person is bound by that decision for the calendar year concerned and the following two calendar years).

The “Member State of consumption” means one of the following: (i) in the case of the supply of services, the State in which the supply is deemed to be made under Chapter 3 of Title V of the VATD (place of supply of services — see, XVII.E.4., above); (ii) in the case of intra-EU distance sales of goods, the State in which the dispatch or transport of the goods to the customer ends; and (iii) in the case of the supply of goods made by a taxable person facilitating those supplies under Article 14a(2) of the VATD, where the dispatch or transport of the goods supplied begins and ends in the same State, that State (“deemed supplier” online platforms — see the discussion of Article 14a(2) at XVII.D.1.a.(2), above).

Building on the former legislative framework established by the MOSS scheme, from July 1, 2021 onwards, the EU VAT due on the following supplies can be declared under the Union scheme: (i) cross-border supplies of TBE services to nontaxable persons within the European Union (as was previously the case); (ii) all other cross-border supplies of services to nontaxable persons within the European Union; (iii) intra-EU distance sales of goods, and (iv) in specific circumstances, certain domestic supplies of goods.

The use of the Union scheme is optional. However, if a taxable person is registered for the Union scheme, it must be used to account for the VAT due on all supplies of goods and services made by that person.

An “intra-EU distance sale of goods” is defined as a supply of goods dispatched or transported by or on behalf of the supplier, including where the supplier intervenes indirectly in the transport or dispatch of the goods, from a Member State other than that in which dispatch or transport of the goods to the customer ends (see the discussion on Article 14a of the VATD at XVII.D.1.a.(2), above). An intra-EU distance sale of goods covers: supplies of goods to non-taxable persons (consumers); supplies of goods (including excise products) to taxable persons or non-taxable legal persons listed in Article 151 of the VATD (i.e., diplomatic arrangements, international bodies, NATO, etc.); and supplies of goods (except excise products) to certain categories of persons that are exempt from VAT, farmers who receive the flat rate addition (see XVII.L.2., above), businesses in the second-hand margin scheme (see XVII.L.4., above) and non-taxable legal persons. The goods must be in free circulation in the European Union before the sale, i.e. the goods must have been produced in the European Union or imported by the supplier into the European Union at some point before the sale.

As noted above, goods will also be considered dispatched or transported by or on behalf of the supplier where the supplier intervenes indirectly in the dispatch or transport of the goods. This includes instances in which: (i) the supplier subcontracts the transport of the goods to a third party, which delivers the goods to the customer; (ii) the transport is provided by a third party, but the supplier bears either total or partial responsibility for the delivery of the goods to the customer; (iii) the supplier invoices and collects the transport fees from the customer

and remits them to the transport company; or (iv) the supplier promotes the delivery services of a third party to the customer, puts the customer and the third party in contact or otherwise provides to the third party the information necessary for the delivery of the goods.

The Union scheme may be used by taxable persons established both inside and outside the European Union.

A taxable person established in the European Union may use the Union scheme to declare and pay EU VAT with respect to: (i) services (including TBE services) supplied to a non-taxable person located in a Member State in which the supplier is not established (meaning that services provided to a non-taxable person in the State in which the supplier is established are/continue to be declared in the supplier’s domestic VAT return); and (ii) intra-EU distance sales of goods. If a person is registered for the Union scheme, the scheme must be used to account for VAT on all supplies made by that person that fall within the scope of the scheme. In other words, once registered for the scheme, it is not possible for the VAT due on some supplies within the scope of the scheme to be accounted for outside the scheme.

A supplier that is not established in the European Union and does not have a fixed establishment in the European Union may use the Union scheme to declare and pay VAT on intra-EU distance sales of goods only. A supplier that is not established and does not have a fixed establishment in the European Union cannot use the Union scheme to declare EU VAT with respect to supplies of B2C services but, instead, can opt to register for the Non-Union scheme discussed in XVII.L.6.b., above to declare the VAT due on such supplies. A taxable person that is neither established, nor has a fixed establishment, in the European Union but has been issued a VAT number by an EU Member State can still choose to register for the Union scheme. Once a person is registered for the Union scheme, the scheme must be used to account for VAT on all supplies within the scope of the scheme. It is not possible for the VAT due on some supplies to be accounted for outside the scheme. This means that suppliers not established in the European Union that choose to register for the Union scheme must account for EU VAT due on all intra-EU distance sales of goods under the scheme.

“Deemed supplier” online platforms (see XVII.D.1.a.(2), above), whether established in or outside the European Union, can register for the Union scheme to allow them to declare and pay EU VAT on intra-EU distance sales of goods, and certain domestic supplies of goods, where the supply is facilitated through the electronic interface and the goods and the customer are located in the same Member State.

Suppliers registered for the Union scheme must apply the VAT rate applicable to their supplies in the Member State of consumption.

Once registered for the Union scheme, a taxable person must meet certain VAT filing, payment and record-keeping requirements. The applicable rules generally mirror those discussed in relation to the Non-Union scheme discussed at XVII.L.6.b., above. The same holds true for the applicable rules on the deduction of VAT (no entitlement to deduct VAT incurred in the Member State of consumption), deregistration and removal from the scheme, and registration for multiple schemes.

d. Special Scheme for Distance Sales of Goods Imported from Third Territories or Third Countries (“Import One Stop Shop”)

Prior to July 1, 2021, goods with a value less than 22 euros were exempt from VAT on importation into the European Union. On July 1, 2021 this exemption was abolished and VAT became chargeable on all imports, including those with a value of less than 22 euros. However, the exemption from customs duty for imports of goods with an intrinsic value of less than 150 euros remained in place (except in the case of goods subject to excise duty), thus creating a discrepancy between VAT and customs duty treatment. To eliminate this discrepancy, the IOSS was introduced as part of the eCommerce Package, with effect from July 1, 2021.

To summarize, under the IOSS, a taxable person not established within the European Union that makes distance sales of goods imported from third territories or third countries can: (i) register in one Member State for all supplies within the scope of the IOSS made across the European Union; (ii) report and remit all import VAT within the scope of the IOSS due across the European Union in one monthly return; and (iii) charge VAT at the applicable rate at the point of sale to a consumer, with the result that goods will proceed through customs without the need for VAT to be paid at the point of importation.

The relevant provisions of the IOSS are set out in Articles 369l through 369x and Article 369zc of the VATD and Articles 57a through 63c of the VAT Implementing Regulation. For purposes of the IOSS, the following definitions prevail:¹⁷²⁴

- (i) A “taxable person not established within the European Union” means a taxable person that neither has established its business nor has a fixed establishment in the territory of the European Union.
- (ii) An “intermediary” means a person established in the European Union appointed by a taxable person making distance sales of goods imported from third territories or third countries as the person liable for the payment of VAT and the fulfillment of the obligations laid down in this special scheme in the name and on behalf of the taxable person.
- (iii) The “Member State of identification” means any of the following: (a) where the taxable person is not established in the European Union, the Member State of identification is the State in which the taxable person chooses to register; (b) where the taxable person has established its business outside the European Union but has one or more fixed establishments in the European Union, the Member State of identification is the State with a fixed establishment in which the taxable person indicates it will make use of this special scheme; (c) where the taxable person has established its business in a Member State, the Member State of identification is that State; (d) where the intermediary has established its business in a Member State, the Member State of identification is that State; (e) where the intermediary has established its business outside the European Union but has one or more fixed establishments in

the European Union, the Member State of identification is the State with a fixed establishment in which the intermediary indicates it will make use of this special scheme. For purposes of (b) and (e), a taxable person or an intermediary that has more than one fixed establishment in the European Union is bound by the decision to indicate the State of establishment as the Member State of identification for the calendar year concerned and the following two calendar years.

(iv) “Member State of consumption” means the Member State in which the dispatch or transport of the goods to the customer ends.

The use of the IOSS is optional. If a supplier opts not to use the IOSS, the arrangements in relation to VAT on imports in place prior to July 1, 2021 continue to apply.

Only goods come within the scope of the IOSS. Products subject to excise duty, in consignments of an intrinsic value not exceeding 150 euros are excluded from the scheme. To this end, “intrinsic value” has the same meaning as it has under the EU Customs Code, i.e.: “(a) for commercial goods: the price of the goods themselves when sold for export to the customs territory of the Union, excluding transport and insurance costs, unless they are included in the price and not separately indicated on the invoice, and any other taxes and charges as ascertainable by the customs authorities from any relevant document(s); (b) for goods of a non-commercial nature: the price which would have been paid for the goods themselves if they were sold for export to the customs territory of the Union.”¹⁷²⁵ Other costs that are not included in the value of the goods themselves must be excluded from the intrinsic value of the goods where those costs are included separately and indicated clearly on the invoice concerned.

For purposes of the IOSS, “distance sales of goods imported from third territories or third countries”¹⁷²⁶ are supplies of goods from a third territory or a third country outside the European Union where the goods are dispatched or transported by or on behalf of the supplier (the taxable person selling the goods) to a non-taxable person or a person treated as such in the European Union. Goods are also considered dispatched or transported by or on behalf of a supplier, where the supplier intervenes indirectly in the dispatch or transport of the goods. This includes the situations in which: (i) the supplier subcontracts the transport of goods to a third party, which delivers the goods to the customer; (ii) the transport is provided by a third party but the supplier bears either total or partial responsibility for the delivery of the goods to the customer; (iii) the supplier invoices and collects the transport fees from the customer and remits them to the transport company; or (iv) the supplier promotes the delivery services of a third party to the customer, puts the customer and the third party in contact or otherwise provides to the third party the information necessary for the delivery of the goods. Goods stored in a warehouse in the European Union do not qualify as distance sales of imported goods. New means of

¹⁷²⁵ See Delegated Regulation (EU) 2015/2446 as amended by Commission Delegated Regulation (EU) 2020/877 of April 3, 2020, Art. 1(48).

¹⁷²⁶ “Third territories” are those referred to in VATD, Art. 6 and “third countries” means any state or territory to which the TFEU is not applicable (see XVII.B.).

¹⁷²⁴ VATD, Art. 369l.

transport and goods supplied after assembly or installation are also excluded.

The IOSS may be used by a taxable person, whether established inside or outside the European Union, to declare sales of goods imported in consignments with an intrinsic value not exceeding 150 euros to customers in the European Union when the goods are located in a third country or third territory at the time they are sold.

Suppliers established in the European Union (including EU-established electronic interfaces that are deemed suppliers — see, XVII.D.1.a.(2), above) will register in their State of establishment as the Member State of identification.

A taxable person established in a third country with which the European Union has concluded a VAT mutual assistance agreement similar in scope to Council Directive 2010/24/EU and Regulation (EU) No 904/2010 (see XVII.N.1., below), can avail itself of the IOSS directly without the appointment of an intermediary.¹⁷²⁷ The decision on whether a country has a VAT mutual assistance agreement similar in scope to Council Directive 2010/24/EU and Regulation (EU) No. 904/2010 lies with the EU Commission.

Suppliers that neither are established nor have a fixed establishment in the European Union and are not established in a third country with which the European Union has concluded a VAT mutual assistance agreement must appoint an EU-established intermediary. The Member State of identification in these cases will be the State in which the intermediary is established. This applies also to non-EU established electronic interfaces that are deemed suppliers. The role of the intermediary is to comply with the IOSS obligations on behalf of the supplier. The intermediary is responsible for the declaration and payment of the VAT due on the importation of qualifying goods. Although the VAT liability remains the liability of the supplier represented by the intermediary, the intermediary is responsible for the payment of the VAT due. Joint and several liability is not a condition of registration as an intermediary and does not apply automatically. To act as an intermediary, a person will first need to register as an intermediary for purposes of the IOSS. On registration, an intermediary is issued a unique identification number, which evidences its registration as an intermediary for purposes of the IOSS. This is neither a VAT number nor a number that can be used to declare sales under the IOSS. The intermediary is also issued an IOSS identification number with respect to each taxable person it represents and that is to be used with respect to sales made by that taxable person alone. A taxable person cannot appoint more than one intermediary at the same time. By contrast, an intermediary can represent more than one taxable person simultaneously.

When availing of the IOSS the supplier or the intermediary will charge VAT at the correct rate at the time of supply to the customer. The time of supply is when the payment has been

accepted by the supplier from the customer. The customer will therefore pay over the full VAT inclusive amount to the supplier at the time the sale is concluded. The rate of VAT to be charged on the goods is the rate in force in the Member State of consumption for that product. The VAT due on the supply is then declared and paid by the supplier or its intermediary via the monthly IOSS return in the Member State in which the taxpayer has registered for the IOSS. The return must be filed by the end of the following month and must contain a breakdown of the total VAT amount to be paid in each Member State.

At the time of import, Customs will validate the IOSS VAT identification number included in the Customs declaration against the centralized IOSS registration database. If the number is confirmed as valid, the goods will be exempt from VAT at import and VAT due on the supply will be declared and paid by the supplier or the intermediary via its monthly IOSS return.

The transporter of the goods (for example, a postal operator or an express carrier) will need to be provided with the IOSS VAT identification of the supplier for the customs clearance of the goods into free circulation and to avoid double taxation at the point of importation.

Once registered for the Union scheme, a taxable person or an intermediary must comply with certain VAT filing, VAT payment and record-keeping obligations. The applicable rules generally mirror those discussed in relation to the Non-Union scheme at XVII.L.6.b., above. The same holds true for the applicable rules on the deduction of VAT (there is no entitlement to deduct VAT incurred in the Member State of consumption), deregistration and removal from the scheme, and registration for multiple schemes.

e. Further developments

On May 17, 2023, as part of a broad and comprehensive reform of the Customs Union, the Commission tabled a Proposal for a Council Directive amending Directive 2006/112/EC as regards VAT rules relating to taxable persons who facilitate distance sales of imported goods and the application of the special scheme for distance sales of goods imported from third territories or third countries and special arrangements for declaration and payment of import VAT.¹⁷²⁸ The Proposal suggests three changes, i.e.: (i) the removal of the 150-euro threshold, rendering all distance sales of imported goods, regardless of value, eligible for the IOSS; (ii) an extension of the deemed supplier rule to all distance sales of imported goods, including those with a value of more than 150 euros, that are facilitated by an electronic interface; and (iii) an extension of the application of the “special arrangements” by removing the 150-euro threshold. If the Proposal is adopted “as is” as a Directive, Member States would have to apply the new rules from March 1, 2028.

M. Value Added Tax Cross-Border Rulings

A test case has been set up to allow taxable persons to obtain advance rulings on the VAT treatment of complex cross-border transactions (VAT Cross-Border Rulings, CBRs.) The project commenced in June 2013.

¹⁷²⁷ See, e.g., the Agreement of February 6, 2018 between the European Union and the Kingdom of Norway on administrative cooperation, fight against fraud and recovery of claims in the area of value added tax, which entered into force in September 2018. The Agreement is the first (and to date the only one) of its kind concluded by the European Union with a non-EU country. The Agreement allows the EU Member States and Norway to cooperate in a similar way to that in which Member States do under Council Regulation (EU) No 904/2010 and Council Directive 2010/24/EU to fight against VAT fraud, and assist each other to recover claims in the field of VAT.

¹⁷²⁸ COM/2023/262 final.

Taxable persons envisaging cross-border transactions between two or more of the participating Member States can request a CBR with regard to the VAT treatment of the transactions they envisage. Currently, the following Member States participate in this project: Belgium, Cyprus, Denmark, Ireland, Estonia, Finland, France, Italy, Latvia, Lithuania, Malta, the Netherlands, Poland, Portugal, Slovenia, Spain and Sweden.

A request for a CBR should be introduced in the participating Member State in which the taxable persons concerned are registered for VAT purposes. If two or more companies are involved, the request should be introduced by only one of them, which also acts on behalf of the others. In principle, a request must be introduced in line with the conditions governing national VAT rulings in the Member State concerned. This does not mean that the conditions governing national VAT ruling requests in a Member State should necessarily apply to requests for cross-border rulings. For example, a Member State may require CBR requests to be introduced in line with the conditions governing other types of requests for advice pursuant to local practice.

A CBR can only be requested if the transaction(s) envisaged are complex and have a cross-border aspect (in two or more participating Member States).

The tax authorities' opinions on cross-border transactions are delivered under the guarantees applying to national rulings, decisions or opinions in the Member States concerned. A CBR does not guarantee that the Member States involved will agree on the VAT treatment of the transactions envisaged.

Decisions are to be made as soon as possible. National rules with regard to response deadlines may not apply to CBR requests.

A CBR applicant must provide a detailed and clear description of its case and of its opinion and/or doubts with regard to the applicable VAT regime so as not to delay the handling of the request and the decision process.

To date, CBRs have been issued with respect to: (i) the place of supply of goods and services and the correct accounting process following a business restructuring; (ii) providing "in-house" training; (iii) organizing a symposium to present new products to clients; (iv) renovating buildings in another Member State; (v) supplying SIM cards for mobile phones; (vi) separate sales of machinery and tires assembled on the machinery; (vii) trading in precious metals spots and deliverable forwards using unallocated accounts; (viii) assigning pitch space to various race tracks, and supplying VIP passes and personalization services at international events; (ix) goods sold and transported from one Member State to another and installed or assembled by the supplier; (x) supply chains, intra-EU sales, and the possibility of dividing an intra-EU supply into a transfer followed by a local supply; (xi) the transformation of crude oil; (xii) organizing in-service teacher training courses in other Member States; (xiii) the exemption for the supply of services by IGPs (cross-border application); (xiv) the place of supply of an intra-EU sale followed by a local supply made by a non-established taxable person; (xv) the place of supply of an intra-EU sale followed by a local supply of goods made by a taxable person not established in the Member State of dispatch but with a fixed establishment in the State of delivery of the goods; (xvi) renting mooring services to intra-EU customers; (xvii) granting credit guarantees; (xviii) the place of service in the case of

the storage of oil products in bulk, a complex of services; (xix) mediation services in transactions involving the leasing or letting of dwellings for a period exceeding one month; (xx) rental car and transport services booked through the internet; (xxi) roadside assistance services; (xxii) the VAT treatment of customization, modification and restoration works on motor vehicles; and (xxiii) the VAT treatment of perishable goods.

The rulings are available on-line, the most recent version being EU VAT Forum — Cross-Border Rulings — Update October 2019.¹⁷²⁹

N. *Administrative Cooperation in the Field of Value Added Tax*

1. *Council Regulation (EU) No. 904/2010*

a. *General*

With effect from January 1, 2012, Council Regulation (EU) No. 904/2010 of October 7, 2010 on administrative cooperation and combating fraud in the field of value added tax (Recast) (VACR)¹⁷³⁰ replaced Council Regulation (EC) No. 1798/2003 of October 7, 2003 on administrative cooperation in the field of value added tax, which was substantially amended on a number of occasions.

The *raison d'être* of the VACR (as of its predecessors) is that, for purposes of collecting the tax due, Member States need to cooperate to help ensure that VAT is correctly assessed. Each Member State must therefore not only monitor the correct imposition of VAT in its own territory, but also provide assistance to other Member States to ensure the correct imposition of VAT relating to activity carried out in their own territory but owed to another Member State. As monitoring the correct application of VAT with respect to cross-border transactions taxable in a Member State other than that in which the supplier is established depends in many cases on information that is either held by the Member State of establishment or can be much more easily obtained by that State, the effective supervision of such transactions is dependent on the Member State of establishment collecting, or being in a position to collect, that information.¹⁷³¹ In cross-border situations, it is important to identify the obligations of each Member State so that the tax can be effectively monitored in the State in which it is due.¹⁷³² Finally, practical experience of the application of Regulation (EC) No. 1798/2003 gained in the fight against carousel

¹⁷²⁹ <https://taxation-customs.ec.europa.eu/system/files/2019-10/cross-border-rulings.pdf>.

¹⁷³⁰ Commission Implementing Regulation (EU) No. 79/2012 of January 31, 2012 (repealing Regulations (EC) No. 1925/2004 and (EC) No. 1174/2009) lays down detailed rules for implementing Council Regulation (EU) No. 904/2010 of October 7, 2010 (VACR), Arts. 14, 32, 48, 49 and 51(1). See also Commission Implementing Regulation (EU) 2020/21 of January 14, 2020 amending Implementing Regulation (EU) No 79/2012 laying down detailed rules for implementing certain provisions of Council Regulation (EU) No 904/2010 concerning administrative cooperation and combating fraud in the field of value added tax; and Commission Implementing Regulation (EU) 2022/1504 of April 6, 2022 laying down detailed rules for the application of Council Regulation (EU) No 904/2010 as regards the creation of a central electronic system of payment information (CESOP) to combat VAT fraud (on this Regulation, see XVII.N.5., below).

¹⁷³¹ VACR, Recitals 7 and 8.

¹⁷³² VACR, Recital 10.

fraud showed that in some cases it is essential to establish a much faster mechanism for the exchange of information, covering much more, and better targeted, information if fraud is to be combated effectively.

b. Institutional Framework

With a view to achieving the objectives discussed in XVII.N.1., above, the VACR sets out the terms under which the competent authorities of the Member States responsible for the application of the laws on VAT are to cooperate with each other and with the Commission to ensure compliance with those laws. To that end, the VACR establishes rules and procedures designed to enable the competent authorities of the Member States to cooperate and exchange with each other any information that may help to effect a correct assessment of VAT, monitor the correct application of VAT, particularly in the context of intra-EU transactions, and combat VAT fraud. In particular, it establishes rules and procedures for Member States on collecting and exchanging such information by electronic means. In addition, the VACR lays down the terms under which the competent authorities are to assist in the protection of VAT revenue in all the Member States, as well as rules and procedures for the exchange by electronic means of VAT information regarding services supplied electronically in accordance with the special scheme provided for in Chapter 6 of Title XII of the VATD (see the discussion of OSS and IOSS at XVII.L.6., above) and for any subsequent exchange of information and, as far as services covered by that special scheme are concerned, for the transfer of money between States' competent authorities.¹⁷³³

To facilitate cooperation and the exchange of information, each Member State must designate a single central liaison office to which principal responsibility for contacts with other Member States in the field of administrative cooperation is delegated and that may also be designated as responsible for contacts with the Commission.¹⁷³⁴ A "central liaison office" is the national office with principal responsibility for contacts with other Member States in the field of administrative cooperation.¹⁷³⁵

The competent authority of each Member State may also designate liaison departments (i.e., any office, other than the central liaison office, designated as such by the competent authority to exchange directly information based on the VACR)¹⁷³⁶ and also, subject to the conditions laid down by the Member State concerned, competent officials¹⁷³⁷ who can directly exchange information based on the VACR.¹⁷³⁸

A liaison department or competent official that sends or receives a request or a reply to a request for assistance must inform the central liaison office of its Member State, subject to the conditions laid down by the latter.¹⁷³⁹ In addition, a liaison department or competent official that receives a request for as-

sistance requiring action outside its territorial or operational area must forward the request without delay to the central liaison office of its Member State and inform the requesting authority that it has done so. The period within which the information must be provided starts to run on the day after the request for assistance is forwarded to the central liaison office.¹⁷⁴⁰

The arrangements summarized above make it clear that there is a distinction between the competent authority, which is legally responsible for exchanges of information and in the name of which such exchanges are carried out, and direct contacts between departments and officials under the delegated legal authority of a competent authority. These arrangements are supervised by a central liaison office, which also acts as the first point of contact. Consequently, no restrictions are imposed on the way in which Member States organize these matters internally beyond the requirement that they have a first point of contact. In other words, the arrangements provide for (a form of) decentralized cooperation, with a pivotal role for central liaison offices.

c. Types of Exchange of Information

The VACR mirrors most bilateral and multilateral tax treaties in that it distinguishes between two basic types of exchange of information: (i) exchange of information on request; and (ii) exchange of information without prior request, which encompasses both the automatic and the spontaneous exchange of information. A competent authority that provides information may ask the competent authority receiving the information to give feedback on it. If such a request is made, without prejudice to the rules on tax secrecy and data protection applicable in its Member State, the competent authority receiving the information is to send the feedback as soon as possible, provided this does not impose a disproportionate administrative burden on it.¹⁷⁴¹

(1) Exchange of Information on Request

The exchange of information entails the making of a request for information by the central liaison office, a liaison department or any competent official of a Member State on behalf of the competent authority of that State (the "requesting authority")¹⁷⁴² to the central liaison office, a liaison department or any competent official of another Member State, which receives the request for assistance on behalf of the competent authority of that State (the "requested authority").¹⁷⁴³

At the request of the requesting authority, the requested authority must communicate the information referred to in Article 1 of the VACR (i.e., any information that may help to effect a correct assessment of VAT, monitor the correct application of VAT, particularly in the context of intra-EU transactions, and combat VAT fraud), including any information relating to a specific case or cases.¹⁷⁴⁴ For that purpose, the requested authority must arrange for the conducting of any administrative enquiries necessary to obtain the information.¹⁷⁴⁵ The request-

¹⁷³³ VACR, Art. 1.

¹⁷³⁴ VACR, Art. 4(1).

¹⁷³⁵ VACR, Art. 2(1)(a).

¹⁷³⁶ VACR, Art. 2(1)(b).

¹⁷³⁷ That is any official who can directly exchange information under the VACR that he or she has been authorized to exchange: VACR, Art. 2(1)(c).

¹⁷³⁸ VACR, Art. 4(2) and (3).

¹⁷³⁹ VACR, Art. 5.

¹⁷⁴⁰ VACR, Art. 6.

¹⁷⁴¹ VACR, Art. 16.

¹⁷⁴² VACR, Art. 2(1)(d).

¹⁷⁴³ VACR, Art. 2(1)(e).

¹⁷⁴⁴ VACR, Art. 7(1).

¹⁷⁴⁵ VACR, Art. 7(2).

ed authority may refuse to communicate information only if: (i) the number and nature of the requests for information made by the requesting authority within a specific period impose a disproportionate administrative burden on the requested authority; (ii) the requesting authority has not exhausted the usual sources of information that it could have used in the circumstances to obtain the information requested, without running the risk of jeopardizing the achievement of the desired end; or (iii) the requested authority has already supplied the requesting authority with information on the same taxable person as a result of an administrative enquiry conducted less than two years previously.¹⁷⁴⁶

Requests for information and administrative enquiries must be sent using a standard form, filled out by the requesting authority.¹⁷⁴⁷

At the request of the requesting authority, the requested authority communicates to the requesting authority any pertinent information it obtains or has in its possession, as well as the results of administrative enquiries, in the form of reports, statements and any other documents, or certified true copies or extracts of reports, etc. Original documents are provided only where this is not contrary to the provisions in force in the Member State in which the requested authority is established.¹⁷⁴⁸

The requested authority must provide the information as quickly as possible and, in any event, no later than three months following the date of receipt of the request. However, where the requested authority is already in possession of the information, this time limit is reduced to a maximum period of one month.¹⁷⁴⁹ A requested authority that is unable to respond to a request by the deadline informs the requesting authority in writing forthwith of the reasons for its inability to do so and when it considers it will likely be able to respond.¹⁷⁵⁰

(2) Exchange of Information Without Prior Request

Some exchanges of information do not require a prior request because they are either automatic (under Article 14 of the VACR) or spontaneous (under Article 15 of the VACR). The competent authority of a Member State must, without prior request, forward the information referred to in Article 1 of the VACR (i.e., any information that may help to effect a correct assessment of VAT, monitor the correct application of VAT, particularly in the context of intra-EU transactions, and combat VAT fraud) to the competent authority of any other Member State where: (i) taxation is deemed to take place in the Member State of destination and the information provided by the Member State of origin is necessary for the effectiveness of the control system of the Member State of destination; (ii) the Member State has grounds for believing that a breach of the VAT legislation has been committed or is likely to have been committed in the other Member State; or (iii) there is a risk of tax loss in the other Member State.¹⁷⁵¹

¹⁷⁴⁶ VACR, Art. 7(4) *juncto* Art. 54(1).

¹⁷⁴⁷ VACR, Art. 8.

¹⁷⁴⁸ VACR, Art. 9.

¹⁷⁴⁹ VACR, Art. 10. In certain special categories of cases, different time limits may be agreed on between the requested and the requesting authorities (VACR, Art. 11).

¹⁷⁵⁰ VACR, Art. 12.

¹⁷⁵¹ VACR, Art. 13(1). The competent authorities of Member States are, by spontaneous exchange, to forward to the competent authorities of other Mem-

d. Limitations on Exchange of Information

The requested authority is not obliged to communicate information if: (i) the number and nature of the requests for information made by the requesting authority within a specific period impose a disproportionate administrative burden on the requested authority; (ii) the requesting authority has not exhausted the usual sources of information that it could have used in the circumstances to obtain the information requested, without running the risk of jeopardizing the achievement of the desired end; or (iii) the requested authority has already supplied the requesting authority with information on the same taxable person as a result of an administrative enquiry conducted less than two years previously.

In addition, there is no obligation to have enquiries made or to provide information on a particular case if the laws or administrative practices of the Member State that would have to supply the information do not authorize the State to make those enquiries or collect or use that information for that State's own purposes.¹⁷⁵² Also, the competent authority of a requested Member State may refuse to provide information where the requesting Member State is unable, for legal reasons, to provide similar information (in which case the Commission must be informed of the grounds for the requested Member State's refusal).¹⁷⁵³ Finally, the provision of information may be refused where it would lead to the disclosure of a commercial, industrial or professional secret, a commercial process, or information whose disclosure would be contrary to public policy.¹⁷⁵⁴ However, none of these grounds should be interpreted as authorizing the requested authority of a Member State to refuse to supply information on a taxable person identified for VAT purposes in the Member State of the requesting authority on the sole basis that this information is held by a bank, other financial institution, nominee or person acting in an agency or fiduciary capacity, or because it relates to ownership interests in a legal person.¹⁷⁵⁵

In all cases, the requested authority must inform the requesting authority of the grounds for refusing a request for assistance.¹⁷⁵⁶

e. Storage and Exchange of Specific Information

Each Member State is required — in principle without delay¹⁷⁵⁷ — to store in an electronic system:¹⁷⁵⁸ (i) the information

ber States any information referred to in Art. 13(1) that has not been forwarded under the automatic exchange referred to in VACR, Art. 14 of which they are aware and that they consider may be useful to those competent authorities (VACR, Art. 15).

¹⁷⁵² VACR, Art. 54(2).

¹⁷⁵³ VACR, Art. 54(3).

¹⁷⁵⁴ VACR, Art. 54(4).

¹⁷⁵⁵ VACR, Art. 54(5).

¹⁷⁵⁶ VACR, Art. 54(6).

¹⁷⁵⁷ VACR, Art. 20.

¹⁷⁵⁸ The main feature of the system is known as the VAT Information Exchange System (VIES), which was initially introduced by Council Regulation No. 218/92 (EEC) and was designed to prevent and deter abuse of the special VAT zero-rating provisions for intra-EU trade that could result from the abolition of tax frontiers between Member States on January 1, 1993. VIES enables companies to obtain rapid confirmation of the VAT numbers of their trading partners and enables VAT administrations to monitor and control the flow of intra-EU trade with a view to detecting all kinds of irregularities.

it collects under Chapter 6 of Title XI of the VATD (see the discussion on OSS and IOSS at XVII.L.6., above); (ii) data on the identity, activities, legal form and address of a person to which it has issued a VAT identification number, collected under Article 213 of the VATD, as well as the date on which that number was issued; (iii) data on VAT identification numbers it has issued that have become invalid and the dates on which those numbers became invalid; (iv) information it collects under Articles 360, 361, 364, 369c, 369f, 369g, 369o, 369p, 369s and 369t and 365 of the VATD; (v) information it collects under points (a) and (b) of Article 143(2) of the VATD, as well as the county of origin, the country of destination, the commodity code, the currency, the total amount, the exchange rate, the item price and the net weight; and (vi) data on the VAT identification numbers referred to in Article 369q of the VATD it has issued and, per VAT identification number issued by any Member State, the total value of the imports of goods exempted under Article 143(1)(ca) of the VATD during each month.¹⁷⁵⁹ To enable this information to be used in the procedures provided for in the VACR, the information must be available for at least five years from the end of the first calendar year in which access to the information is to be granted.¹⁷⁶⁰ Member States must ensure that the information available in the electronic system is kept up-to-date, and is complete and accurate.¹⁷⁶¹ Every Member State must grant the competent authority of any other Member State automated access to the information so stored.¹⁷⁶²

f. Request for Administrative Notification

The requested authority must, at the request of the requesting authority and in accordance with the rules governing the notification of similar instruments in the Member State in which the requested authority is established, notify the addressee of all instruments and decisions that emanate from the competent authorities and concern the application of VAT legislation in the territory of the Member State in which the requesting authority is established.¹⁷⁶³

g. Presence in Administrative Offices; Participation in Administrative Enquiries; Common/Simultaneous Controls

By agreement between the requesting authority and the requested authority, and in accordance with the arrangements laid down by the latter, officials authorized by the requesting authority may, with a view to the exchange of information, be present in the offices of the administrative authorities of the requested Member State or any other place where those authorities carry out their duties, and be present during the administrative enquiries carried out in the territory of the requested Member State. (The administrative enquiries are to be carried out exclusively by the officials of the requested authority and the officials of the requesting authority are not to exercise the powers of inspection conferred on officials of the requested au-

thority).¹⁷⁶⁴ This facility goes beyond what is typically provided for in the mutual assistance clauses of bilateral tax treaties. In addition, Member States may agree to carry out simultaneous controls whenever they consider such controls to be more effective than controls carried out by only one Member State.¹⁷⁶⁵

Common/simultaneous controls are organized as follows: a Member State identifies independently the taxable persons that it intends to propose for a simultaneous control and the competent authority of that Member State notifies the competent authority of the other Member States concerned of the cases proposed for simultaneous control. The proposing Member State gives reasons for its choice, as far as possible, by providing the information that led to its decision and specifies the period of time during which the controls should be carried out. The competent authority of the Member State that receives the proposal for simultaneous control confirms its agreement or communicates its reasoned refusal to its counterpart authority, in principle within two weeks of receipt of the proposal, but within a month at the latest. Each competent authority of the Member States concerned appoints a representative to be responsible for supervising and coordinating the control operation.¹⁷⁶⁶

Common/simultaneous controls should be considered in conjunction with the Fiscalis “bilateral or multilateral controls,” i.e., the coordinated checking of the tax liability of one or more related taxable persons organized by two or more countries with common or complementary interests that include at least one Member State.¹⁷⁶⁷ Such controls may be organized simultaneously, but that is not obligatory.

h. Eurofisc

To promote and facilitate multilateral cooperation in the fight against VAT fraud, Eurofisc serves as a network for the swift exchange of targeted information between Member States. Within the framework of Eurofisc, Member States are to: (i) establish a multilateral early warning mechanism for combating VAT fraud; (ii) coordinate the swift multilateral exchange of targeted information in the subject areas in which Eurofisc will operate (the “Eurofisc working fields”); (iii) coordinate the work of the Eurofisc liaison officials of the participating Member States in acting on warnings received; and (iv) coordinate participating Member States’ administrative enquiries into fraud identified by the Eurofisc liaison officials without the power to require Member States to carry out administrative enquiries.¹⁷⁶⁸ Member States participate in the Eurofisc working fields of their choice and may also decide to terminate their participation in those fields.¹⁷⁶⁹ Member States that choose to take part in a Eurofisc working field participate actively in the multilateral exchange of targeted information between all

¹⁷⁵⁹ VACR, Art. 17(1). The enumeration takes account of the amendments introduced by Commission Regulation (EU) 2017/2454 discussed at XVII.N.1.b.

¹⁷⁶⁰ VACR, Art. 18.

¹⁷⁶¹ VACR, Art. 19.

¹⁷⁶² VACR, Art. 21(1).

¹⁷⁶³ VACR, Art. 25.

¹⁷⁶⁴ VACR, Art. 28(1) and (2).

¹⁷⁶⁵ VACR, Art. 29.

¹⁷⁶⁶ VACR, Art. 30(1)–(3).

¹⁷⁶⁷ Regulation (EU) No. 1286/2013 of the European Parliament and of the Council of December 11, 2013 establishing an action program to improve the operation of taxation systems in the EU for the period 2014–20 (Fiscalis 2020) and repealing Decision No. 1482/2007/EC (Fiscalis 2013).

¹⁷⁶⁸ VACR, Art. 33(2).

¹⁷⁶⁹ VACR, Art. 34(1).

participating Member States. Information exchanged is confidential.¹⁷⁷⁰

The Commission provides Eurofisc with technical and logistical support. However, the Commission has no access to the information exchanged over Eurofisc.¹⁷⁷¹

The competent authorities of each Member State designate at least one Eurofisc liaison official to be a competent official within the meaning of Article 2(1)(c) of the VACR (see XVII.N.1.b., above) — the liaison officials of the Member States participating in a particular Eurofisc working field (“participating Eurofisc liaison officials”): collate the information received from the participating Eurofisc liaison officials and make all information available to the other participating Eurofisc liaison officials (information to be exchanged by electronic means); ensure that the information received from the participating Eurofisc liaison officials is processed, as agreed by the participants in the working field, and make the result available to the participating Eurofisc liaison officials; provide feedback to the participating Eurofisc liaison officials; and submit an annual report on the activities of the working field to the liaison officials of the Member States.¹⁷⁷²

i. Exchange and Conservation of Information in the Context of the Procedure for the Refund of Value Added Tax to Taxable Persons Established Not in the Member State of Refund but in Another Member State

Article 48 of the VACR governs the exchange and preservation of information in the context of the VAT refund procedure under Council Directive 2008/9/EC of February 12, 2008 laying down detailed rules for the refund of value added tax, provided for in the VATD, to taxable persons established not in the Member State of refund but in another Member State (see, XVII.J.3., above).

j. Relations with the Commission

The Member States and the Commission will examine and evaluate how the arrangements for administrative cooperation provided for in the VACR are working, allowing the Commission to pool Member States’ experience with the aim of improving the operation of those arrangements. The Member States are to communicate to the Commission any available information, including statistical data, relevant to their application of the VACR. With a view to evaluating the effectiveness of this system of administrative cooperation in combating tax evasion and tax avoidance, Member States may communicate to the Commission any other information than that which is the subject matter of the VACR. All the information referred to above will be forwarded by the Commission to the other Member States concerned. Where necessary, in addition to what is required by other provisions of the VACR, the Commission will send to the competent authorities of each Member State any information that might enable them to combat fraud in the field of VAT as soon as it obtains such information. Finally, the Commission may, at the request of a Member State, provide its expert opinions, technical or logistical assistance, or

any other support with a view to achieving the objectives of the VACR.¹⁷⁷³

k. Relations with Third Countries

A competent authority of a Member State that receives information from a third country may pass the information on to the competent authorities of Member States that might be interested in it and, in any event, to all those that request it, to the extent permitted by assistance arrangements with that particular third country.

A competent authority may communicate, under its domestic provisions on the communication of personal data to third countries, information obtained under the VACR to a third country, provided: (i) the competent authority of the Member State from which the information originates has consented to that communication; and (ii) the third country concerned has given an undertaking to provide the cooperation required to gather evidence of the irregular nature of transactions that appear to contravene the VAT legislation.

l. Confidentiality

Information communicated or collected in any form under the VACR, including any information to which an official has had access in the circumstances set out in Chapters VII., and X.,¹⁷⁷⁴ and in the cases referred to in paragraph 2 of Article 55,¹⁷⁷⁵ is covered by the obligation of official secrecy and enjoys the protection extended to similar information under both the national law of the Member State that received it and the corresponding provisions applicable to EU authorities.¹⁷⁷⁶ Such information is to be used only in the circumstances provided for in the VACR.

However, such information may be used for purposes of establishing the assessment base or the collection or administrative control of tax for purposes of establishing the assessment base. It may also be used for the assessment of other levies, duties and taxes covered by Article 2 of Council Directive 2008/55/EC of May 26, 2008 on mutual assistance for the recovery of claims relating to certain levies, duties, taxes and other measures (as amended and restated).¹⁷⁷⁷ In addition, it may be used in connection with judicial proceedings that may involve penalties, initiated as a result of infringements of tax law without prejudice to the general rules and legal provisions governing the rights of defendants and witnesses in such proceedings.

By way of derogation from the above, the competent authority of the Member State providing the information will permit its use for other purposes in the Member State of the requesting authority, if, under the legislation of the Member State

¹⁷⁷³ VACR, Art. 49.

¹⁷⁷⁴ In particular, the Chapters on Presence in Administrative Offices and Participation in Administrative Enquiries, Simultaneous Controls and Provision of Information to Taxable Persons (see XXI.B.5.a., below).

¹⁷⁷⁵ VACR, Art. 55, para. 2 provides that persons duly accredited by the Security Accreditation Authority of the Commission may have access to this information only insofar as is necessary for the care, maintenance and development of the common communication network (CCN)/common system interface (CSI) network.

¹⁷⁷⁶ VACR, Art. 55.

¹⁷⁷⁷ See XVII.B.

¹⁷⁷⁰ VACR, Art. 34(2) and (3).

¹⁷⁷¹ VACR, Art. 35.

¹⁷⁷² VACR, Art. 36(1) and (2).

of the requested authority, the information can be used for similar purposes.

Also, where the requesting authority considers that information it has received from the requested authority is likely to be useful to the competent authority of a third Member State, it may transmit it to the latter authority after informing the requested authority in advance. The requested authority may require that the transmission of the information to a third party be subject to its prior agreement

m. Miscellaneous

Reports, statements and any other documents, or certified true copies or extracts from such documents, obtained by the staff of the requested authority and communicated to the requesting authority under the assistance provided for by the VACR may be invoked as evidence by the competent bodies of the Member State of the requesting authority on the same basis as similar documents provided by another authority of that State.¹⁷⁷⁸

The VACR is without prejudice to the fulfillment of any wider obligations in relation to mutual assistance ensuing from other legal acts, including bilateral or multilateral agreements. A Member State that concludes a bilateral arrangement on matters covered by the VACR, other than to deal with individual cases, must inform the Commission without delay. The Commission will in turn inform the other Member States.¹⁷⁷⁹

2. Distance Sales

Due to the extension from January 1, 2021 of the special schemes provided for by Chapter 6 of Title XII of the VATD to distance sales of goods and services other than TBE services (see the discussion of OSS and IOSS at XVII.L.6., above), Council Regulation (EU) 2017/2454 of 5 December 2017 amending Regulation (EU) No 904/2010 on administrative co-operation and combating fraud in the field of value added tax complemented the scope of the VACR by laying down rules and procedures for the exchange by electronic means of VAT information on goods and services supplied in accordance with the special schemes referred to above and also for any subsequent exchange of information and, as far as goods and services covered by the special schemes are concerned, for the transfer of money between Member States' competent authorities. See also XVII.N.1.e., above.

3. Value Added Tax Fraud — Council Regulation (EU) 2018/1541 of October 2, 2018

On October 2, 2018, the Council adopted Council Regulation (EU) 2018/1541 amending Regulations (EU) No. 904/2010 and (EU) 2017/2454 as regards measures to strengthen administrative cooperation in the field of value added tax (the "VAT Fraud Regulation"). The overall objective of the VAT Fraud Regulation is to provide for new tools to make the European Union's VAT system more fraud-proof and close loopholes that can lead to large-scale VAT fraud.

One of the drivers of the adoption of the VAT Fraud Regulation was, without doubt, the VAT Gap, i.e., the difference

between the expected VAT revenue (i.e., the total VAT revenue that would be collected in the case of full VAT compliance) and the VAT actually collected by national authorities. A VAT Gap study conducted by CASE & Institute for Advanced Studies had estimated that in total about 152 billion euros were lost in 2015 due to shortcomings in VAT collection, including fraud,¹⁷⁸⁰ while earlier estimates had put the losses attributable to cross-border fraud alone at 50 billion euros.¹⁷⁸¹ Although the VAT Gap has in the recent years diminished, it remains an area of concern.¹⁷⁸²

The VAT Fraud Regulation adds measures to the VACR specifically designed to tackle VAT fraud schemes, in particular MTIC or carousel fraud,¹⁷⁸³ used car fraud,¹⁷⁸⁴ and fraud involving customs procedures 42 and 63.¹⁷⁸⁵

Some of the measures under the VAT Fraud Regulation became applicable as from the day of entry into force of the Regulation, others from January 1, 2020.

4. Call-Off Stock Arrangements

Following the simplification introduced by Council Directive (EU) 2018/1910 as regards call-off stock arrangements (see XVII.D.1.a.(4), above), Council Regulation (EU) 2018/1909 of December 4, 2018 amending Regulation (EU) No 904/2010 as regards the exchange of information for the purpose of monitoring the correct application of call-off stock arrangements adds provisions to the VACR to the effect that the relevant competent authorities of the Member States have automated access to the data collected from taxable persons with re-

¹⁷⁸⁰ CASE & Institute for Advanced Studies, Study and Reports on the VAT Gap in the EU-28 Member States: 2017 Final Report, 2017.

¹⁷⁸¹ Ernst and Young, Implementing the "destination principle" for intra-EU B2B supplies of goods, 2015.

¹⁷⁸² In 2020, the VAT gap amounted to 93 billion euros and 9.1% of the VAT total tax liability revenue assuming full VAT compliance (VTTL). Compared to 2019, this decreased by approximately 2 percentage points of the VTTL and 31 billion euros, despite some likely overestimation of its size as a result of the insufficient inclusion of late payments in the deferred VAT revenue. Overall, between 2016 and 2020, the gap in the EU27 declined by 31 billion euros and 3.3 percent points of the VTTL (see, European Commission, CASE, Poniatowski, G., Bonch-Osmolovskiy, M., Śmietanka, A., Pechcińska, A., *VAT gap in the EU — Report 2022*, Publications Office of the European Union, Luxembourg, published on December 8, 2022, <https://data.europa.eu/doi/10.2778/109823>). According to the VAT Gap Report 2023, the overall EU VAT Gap decreased by around 38 billion euros — from 99 billion euros in 2020 to 61 billion euros in 2021 (see, European Commission, Directorate-General for Taxation and Customs Union, Poniatowski, G., Bonch-Osmolovskiy, M., Śmietanka, A. et al., *VAT gap in the EU — 2023 report*, Publications Office of the European Union, 2023, <https://data.europa.eu/doi/10.2778/911698>).

¹⁷⁸³ On the concept of "MTIC" fraud, see XVII.K.1.b. above. The European Court of Auditors and Europol have estimated that "missing trader intra-Community" (MTIC) fraud could account for 40 to 60 billion euros in annual VAT revenue losses and that 2% of organized crime groups could be behind 80% of the fraud.

¹⁷⁸⁴ As a result of the dual VAT regime applicable to cars ("margin scheme" (see, XVII.L.4., above) or normal arrangements), trading in cars is often subject to VAT fraud. The easiest way to commit fraud is to sell recent or new means of transport (where the whole amount is taxable) as second-hand goods (where only the margin is taxable).

¹⁷⁸⁵ The scheme for importing goods free of VAT (customs procedures 42 and 63), implemented to ease trade where the goods are immediately delivered to a business in another Member State, is often abused and the goods diverted to the black market without VAT having been paid. This type of fraud sometimes occurs in conjunction with the fraudulent undervaluation of the goods to avoid customs duties.

¹⁷⁷⁸ VACR, Art. 56.

¹⁷⁷⁹ VACR, Art. 60.

spect to such transactions, thus enabling them to monitor their correct application.

5. *Cross-Border E-Commerce — Payment Service Providers*

With effect from January 1, 2024, Council Directive (EU) 2020/284 of February 18, 2020 (see XVII.K.4., above) alongside Council Regulation (EU) 2020/283 of February 18, 2020 amending Regulation (EU) No 904/2010 as regards measures to strengthen administrative cooperation in order to combat VAT fraud complements introduced new record-keeping and reporting obligations for payment service providers performing payment services within the European Union.

The adoption of these legislative instruments must be seen in the factual context of fraudulent businesses exploiting cross-border e-commerce opportunities to gain unfair market advantages by evading their VAT obligations. Cross-border e-commerce in this context refers to supplies on which VAT is due in a Member State, where the supplier is established in another Member State, a third territory or a third country). For the vast majority of cross-border online purchases made by consumers in the European Union, payments are executed through payment service providers. Such providers hold specific information allowing them to identify the recipient or payee of a cross-border payment together with details of the date, the amount and the Member State of origin of the payment. For tax authorities to be able carry out their basic tasks of detecting fraudulent businesses and determining VAT liabilities in relation to cross-border e-commerce supplies, it is necessary for the VAT-relevant information held by payment service providers to be made available to the Member States and the Member States to have the ability to store it in their national electronic systems and transmit it to a central electronic system of payment information to enable the detection and combatting of cross-border VAT fraud, particularly as regards B2C supplies.

For administrative cooperation and related exchange of information purposes, Council Regulation (EU) 2020/283 establishes a central electronic system of payment information (CESOP), developed, maintained, hosted and technically managed by the Commission, to which Member States are to transmit the payment information that they collect from payment service providers¹⁷⁸⁶ and that is stored at national level.

CESOP stores, aggregates and analyzes, in relation to individual payees, all VAT-relevant information regarding payments transmitted by Member States and makes available to the Eurofisc liaison officials the results of specific analyses of information. CESOP should be able to recognize multiple records of the same payment (for example, the same payment may be reported both by the bank and the card issuer of a given payer) and to clean the information received from the Member States (for example, by removing duplicates and correcting errors in data). It should also allow Eurofisc liaison officials

¹⁷⁸⁶ A “payment service provider” means any of the categories of payment service providers listed in Art. 1(1), points (a) to (d) of Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC or a natural or legal person benefiting from an exemption in accordance with Art. 32 of that Directive.

to cross-check payment information with the VAT information they hold, to make enquiries for purposes of an investigation into suspected VAT fraud or to detect VAT fraud, and to add supplementary information. CESOP is to retain the information transmitted to it for a maximum period of five years from the end of the year in which the information was transmitted to it.

See also Commission Implementing Regulation (EU) 2022/1504 of April 6, 2022 laying down detailed rules for the application of Council Regulation (EU) No 904/2010 as regards the creation of a central electronic system of payment information (CESOP) to combat VAT fraud.

6. *Value Added Tax in the Digital Age Package*

As part of the VAT in the Digital Age (ViDA) Package, Council Regulation (EU) 2025/517 of March 11, 2025 amending Regulation (EU) No 904/2010 as regards the VAT administrative cooperation arrangements needed for the digital age introduced certain amendments to the VACR.¹⁷⁸⁷ The Regulation introduces a central electronic VAT information exchange system (central VIES) for sharing data on intra-Community transactions to combat VAT fraud effectively.

Member States are required to establish national systems to automatically transmit VAT information to the central VIES, ensuring timely updates and reliable data to facilitate monitoring and cross-checking of transactions, which will help maintain accurate VAT identification and improve fraud detection capabilities. The Regulation emphasizes the importance of protecting personal data, outlines the framework for implementing the new digital reporting requirements, and acknowledges the need for technological development for the central VIES, while ensuring that existing VAT controls remain operational during the transition. The amendments become applicable as from July 1, 2028 onwards.

O. *VAT in the Digital Age (ViDA) Package*

On December 8, 2022, the Commission published its ViDA Package. The Package comprised three proposals:

- (i) A Council Directive amending Directive 2006/112/EC as regards VAT rules for the digital age;¹⁷⁸⁸
- (ii) A Council Regulation amending Regulation (EU) No 904/2010 as regards the VAT administrative cooperation arrangements needed for the digital age;¹⁷⁸⁹ and
- (iii) A Council Implementing Regulation amending Implementing Regulation (EU) No 282/2011 as regards information requirements for certain VAT schemes.¹⁷⁹⁰

As part of the legislative process, the European Parliament was consulted and delivered its initial (non-binding) Report on November 22, 2023.¹⁷⁹¹

¹⁷⁸⁷ Council Regulation (EU) 2025/517 of March 11, 2025 amending Regulation (EU) No 904/2010 as regards the VAT administrative cooperation arrangements needed for the digital age <https://eur-lex.europa.eu/eli/reg/2025/517/oj/eng>.

¹⁷⁸⁸ COM/2022/701 final.

¹⁷⁸⁹ COM/2022/703 final.

¹⁷⁹⁰ COM/2022/704 final.

¹⁷⁹¹ <https://eur-lex.europa.eu/eli/C/2024/4246/oj/eng>; see also https://www.europarl.europa.eu/doceo/document/A-9-2023-0327_EN.html#_section2.

On November 5, 2024, the Council reached political agreement on the ViDA package. However, given the substantial differences between the Commission's proposals on which the European Parliament was initially consulted and the compromise text of the Council, the Council decided on November 7, 2024 to re-consult the European Parliament. In its February 12, 2025 Report, the Parliament supported the Council agreement, without amendments.¹⁷⁹²

The ViDA Package was formally adopted by the EU Council on March 11, 2025,¹⁷⁹³ and published in the Official Journal of March 25, 2025.

The ViDA Package has three main objectives or “pillars:”

(i) Modernizing VAT reporting obligations (i.e., the obligations of VAT-registered businesses to make periodic declarations of their transactions to the tax authority to allow the collection of VAT to be monitored) by introducing digital reporting requirements (DRRs) intended to standardize the information to be submitted by taxable persons to the tax authorities regarding all transactions in an electronic format, based on e-invoicing for cross-border transactions (“First Pillar”);

(ii) Addressing the challenges of the platform economy (i.e., supplies of services made via a platform) by updating the VAT rules applicable to the platform economy so as to address the issue of equal treatment, clarifying the place of supply rules applicable to these transactions and enhancing the role of platforms in the collection of VAT when they facilitate the supply of short-term accommodation rental or passenger transport services (“Second Pillar”); and

(iii) Avoiding the need for multiple VAT registrations and improving the functioning of the tool implemented for the declaration and payment of the VAT due on distance sales of goods by introducing Single VAT Registration (SVR) (“Third Pillar”).

These components are discussed in the following sections.

1. First Pillar: Value Added Tax Reporting and Digital Reporting Requirements

a. General Overview

The VATD granted Member States a wide discretion to introduce the obligations they deem necessary to ensure the correct collection of VAT and to prevent evasion, thus resulting in varying digital reporting requirements (DRRs) from one Member State to another. DRRs can consist of:

- (i) The transmission of monthly reports of business transactions;
- (ii) The real-time submission of invoices;
- (iii) The real or quasi-real time transmission of invoice data; or
- (iv) The submission of tax and accounting data or VAT records.

Other Member States have implemented non-digital tools for reporting transactions, such as listings that do not provide data at a transactional level but only the values of sales or purchases per customer or supplier (listings of suppliers and customers). All these requirements are in addition to the requirement to submit VAT returns. The resulting fragmentation in the regulatory framework imposes additional compliance costs for businesses that operate in more than one Member State and therefore have to meet varying local requirements and creates barriers within the single market. In addition, the current system for reporting intra-EU transactions (referred to in the VATD as “recapitulative statements” — see XVII.K.6., above) does not allow Member States to tackle VAT fraud linked to these transactions effectively.

The First Pillar of ViDA is aimed at resolving these issues by the introduction of a transaction-by-transaction reporting system that is to provide information to Member States in almost real time based on a common (“harmonized”) reporting template.

b. Transition Process

The transition to mandatory EU e-invoicing and digital reporting for VAT purposes is structured as a three-stage process.

(1) Stage One — 2025 — Member States May Mandate E-Invoicing

Taking effect taking effect 20 days after the publication of the ViDA package in the Official Journal (i.e. April 14, 2025 as publication occurred on March 25, 2025), Member States will be allowed to make the issuing of e-invoices mandatory for domestic supplies without having to obtain a derogation c.q. authorization from the EU Council. Member States may also stipulate that a customer is obliged to accept e-invoices from that date. The EU Council urges Member States to gradually introduce e-invoicing in stages to accommodate SMEs.

(2) Stage Two — 2030 — E-Invoicing Required for Some Cross-Border Services

From July 1, 2030 onwards, VAT registered businesses will be obliged to issue an e-invoice (i.e. a machine-readable structured file) for cross-border business-to-business (“B2B”) and business-to-government (“B2G”) supplies within the EU. The e-invoice should be issued, in principle within 10 days of making a VAT taxable supply of goods or services, in accordance with the European e-invoice standard EN16931 (as updated on February 13, 2026), allowing for automatic processing in ERP systems. The e-invoice data should in principle be reported digitally by the supplier and the customer to the EU tax authorities in (almost) real-time.

This should allow the EU tax authorities to cross-check transactional data, to identify potential VAT non-compliance

¹⁷⁹² https://www.europarl.europa.eu/doceo/document/TA-10-2025-0012_EN.html.

¹⁷⁹³ Council Directive (EU) 2025/516 of March 11, 2025 amending Directive 2006/112/EC as regards VAT rules for the digital age https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=OJ:L_202500516.

Council Regulation (EU) 2025/517 of March 11, 2025 amending Regulation (EU) No 904/2010 as regards the VAT administrative cooperation arrangements needed for the digital age <https://eur-lex.europa.eu/eli/reg/2025/517/oj/eng>.

Council Implementing Regulation (EU) 2025/518 of March 11, 2025 amending Implementing Regulation (EU) No 282/2011 as regards information requirements for certain VAT schemes https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=OJ:L_202500518.

and VAT fraud in (almost) real-time. Mandatory digital reporting applies to intra-EU transactions, i.e. intra-Community supplies and acquisitions (and certain transactions treated as intra-Community acquisitions), transfer of own goods (unless the special scheme for transfer of own goods is used¹⁷⁹⁴), and supplies for which VAT is reverse-charged (unless the supply is exempt without a right to deduct VAT).

The data must be provided to the Member State that issued the VAT identification number used for the transaction in question. The data to be reported, i.e. essentially the data included in the e-invoice, are set out in new Article 264 of the VATD. The data collected by the Member States in their national databases is transferred to a central electronic VAT information exchange system ('central VIES') within one day, where it is stored for ten years.

The obligation to submit recapitulative statements (see XVII.K.6., above) will be abolished as it will be replaced by the DRRs for intra-EU transactions. The exchange of information reported via the recapitulative statements will be maintained until July 1, 2032. Beyond that period the information collected via recapitulative statements will be accessible on request.

(3) Stage Three — 2035 — Mandatory EU E-Invoicing and Reporting Systems

Member States that have mandatory B2B e-invoicing for domestic transactions already in place on January 1, 2024 (e.g. Italy and Germany), with others to follow (e.g. Belgium and France in 2026), will need to converge into the mandatory EU e-invoicing and digital reporting system at the latest by January 1, 2035, with a view to achieving harmonization of e-invoicing and digital reporting obligations across EU Member States from that date. This deadline will be postponed in case of any shortcomings related to the mandatory EU e-invoicing and digital reporting system, which will be evaluated by the Commission by March 2033.

2. Second Pillar: Value Added Tax Treatment of Platform Economy

In addition to the existing deemed supplier rules for platforms facilitating certain B2C supplies of digital services and e-commerce supplies of goods (see XVII.D.1.a.(1) and 3.a.(2), above), the Second Pillar of ViDA introduces new deemed supplier rules for platforms facilitating short-term accommodation rentals (i.e. uninterrupted rentals to the same customer for up to 30 nights) and for platforms facilitating passenger transport by road services. These platforms will also be deemed suppliers under conditions, making them responsible for charging, collecting and remitting VAT. For these purposes, facilitation means that the platform must enable a customer and a supplier to enter into contact, resulting in a supply of services through the platform.¹⁷⁹⁵

¹⁷⁹⁴ ViDA introduces a new scheme simplifying the VAT compliance obligations associated with certain transfers of own goods under the existing OSS regime, which will, as of July 1, 2028, consist of four schemes: the non-Union scheme, 45 the Union scheme, 46 the import One Stop Shop (I-OSS) and the transfer of own goods scheme.

¹⁷⁹⁵ Platforms that meet the following three conditions cumulatively are considered not to facilitate the supply: (i) the platform does not directly or indirectly set any of the terms and conditions under which the supply is made; (ii) the platform is not directly or indirectly involved in authorizing the charge in

The deemed supplier rules must be implemented by the Member States by January 1, 2030, with an opt-in available from July 1, 2028.

However, the platform will not be liable to account for VAT if the underlying supplier provides a valid VAT identification number (effective in the Member State where the VAT is due) to the platform operator and commits to the platform operator to charging VAT. Therefore, the deemed supplier rule is principally intended to apply in circumstances where the underlying supplier is not required to account for VAT on the supply.

In addition, in deviation from the initial Commission proposals, Member States may opt to exclude supplies under the scheme or small enterprises (see, XVII.L.1.), while those under the Tour Operators Margin Scheme (TOMS) (see, XVII.L.3.) must be excluded. The exclusions mean that a platform will be liable for VAT on the full sales price paid by the customer as opposed to merely its own intermediation fee. Conversely, the new VAT liability for platforms will not apply to supplies made under TOMS.

If the platform has not applied the deeming provision, but it later turns out that it should have, the platform is not required to remit the VAT on the underlying service if three conditions are cumulatively met:

- (i) The platform is dependent on information provided by the supplier;
- (ii) That information is erroneous; and
- (iii) The platform can prove that it did not and could not reasonably have known that the information was erroneous.

The place of supply of a platform's B2B facilitation services is the place where the recipient of the service is established. The VAT due may be reverse-charged if the supplier is not established in the Member State where VAT is due. The place of supply of a platform's B2C facilitation services will be subject to VAT in the Member State of the underlying supply, i.e. in principle the Member State of the accommodation or in which the passenger transport by road takes place (which is in line with the place of supply rules for intermediary services).

3. Third Pillar: Single Value Added Tax Registration

As, under the current VATD rules, businesses carrying out transactions taxed in other Member States still face considerable VAT compliance burdens and costs, constituting a barrier within the single market, ViDA provides for extensions of the scope of the OSS and IOSS (see XVII.L.6., above) so as to ensure a further decrease in the need for multiple VAT registrations in the European Union. A fourth scheme is added, i.e., the special scheme for transfer of own goods.

The extensions are to take effect from January 1, 2028 onwards.

respect of payments made; and (iii) the platform is not directly or indirectly involved in the provision of the services. Payment service providers, companies that only provide listings or advertisements, or those that redirect or transfer customers to other electronic interfaces without further intervention in the service, are also excluded from the scope of the deeming provision.

4. Implementation Strategy

On September 24, 2025, the EU Commission released its Implementation Strategy for ViDA, which set out the actions that the Commission will deploy to support businesses and Member States with the implementation of the ViDA package.¹⁷⁹⁶ The implementation strategy provides a roadmap with key action points and dates aimed at ensuring coordinated and effective application.

The Commission points out that at least six Commission Implementing Regulations will be necessary, as follows:

- (i) A Commission Implementing Regulation relating to Article 263(4) of the VAT Directive (DRR);
- (ii) Two Commission Implementing Regulations relating to the creation of Central VIES (DRR). One on the Central VIES design and one on access to Central VIES;
- (iii) A Commission Implementing Regulation relating to secure IOSS (Single Value Added Tax Registration (SVR));
- (iv) Two Commission Implementing Regulations amending Commission Implementing Regulation (EU) 194/2020, to provide the technical and procedural framework for the SVR which enter into force on January 1, 2027, and on July 1, 2028;
- (v) Possibly another Commission Implementing Regulation to ensure the harmonized application of rules that may enter into force on July 1, 2030.

The Commission also announced that it will develop detailed explanatory notes on each of the three pillars in collaboration with Member States and businesses. The aim of the notes is to ensure that all actors have the same understanding of how the legislation should be implemented. The explanatory notes will cover, for example: the definition of e-invoices (for DRR); the practical application of the deemed supplier regime (for platforms, including the VAT identification number checks a platform is required to carry out on the underlying supplier); or the operation of the new transfer of own goods module and the mandatory reverse charge (for SVR). These explanatory notes are expected to be published in Q4 2026 and Q1 2027.

P. Future Prospects — Towards a Definitive VAT System?

1. General

As noted at XVII.A., above, the VATD, which essentially applies an origin-based taxation regime, was designed (and intended) to lay down a transitional system, pending the realization of a simpler and fraud-proof definitive VAT system that would purportedly be based on a country-of-destination principle.

The idea of such a definitive VAT system is all but new: in 1967, the commitment had already been made to establish a definitive VAT system operating within the European Union in the same way as it would within a single country. The need to

abolish the fiscal frontiers between Member States by the end of 1992 made it necessary to reconsider the way in which trade in goods was taxed in the European Union. The goal was that goods should be taxed in the country of origin, so that the same conditions that apply to domestic trade would also apply to intra-EU trade, reflecting the idea of a genuine internal market. However, at the time, political and technical conditions were not ripe for such a system and, consequently, the realization of a definitive VAT system became a long-term objective.

The most recent initiative towards a definitive VAT system is the Proposal for a Council Directive amending Directive 2006/112/EC as regards harmonizing and simplifying certain rules in the value added tax system and introducing the definitive system for the taxation of trade between Member States, launched by the Commission on October 4, 2017, and complemented by the Proposal for a Council Directive amending the VATD of May 25, 2018 as regards the introduction of the detailed technical measures for the operation of the definitive VAT system for the taxation of trade between Member States (the “2018 Proposed Directive”) (see XVII.P.2., below). The chances of success of these Proposals would seem to be minimal to non-existent.

Perhaps as a plan B, therefore, on March 11, 2025, the EU Council adopted the VAT in the Digital Age (ViDA) Package (see, XVII.O., above).

2. Towards a Definitive Value Added Tax System?

In its April 7, 2016 Action Plan,¹⁷⁹⁷ the Commission announced, *inter alia*, its intention to adopt a definitive VAT system for intra-EU cross-border trade based on the principle of taxation in the Member State of destination of the goods with a view to creating a robust single European VAT area. A legislative proposal for this simpler, fraud-proof definitive VAT system for intra-EU trade was included in the Commission Work Programme for 2017.¹⁷⁹⁸

The Proposal for a Council Directive amending Directive 2006/112/EC as regards harmonizing and simplifying certain rules in the value added tax system and introducing the definitive system for the taxation of trade between Member States (the “2017 Proposed Directive”),¹⁷⁹⁹ which was launched by the Commission on October 4, 2017, introduces the cornerstones of the definitive system for intra-EU B2B trade. Specifically, it is designed to replace the transitional arrangements, which

¹⁷⁹⁷ Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee: On an Action Plan on VAT — Towards a single EU VAT area — Time to decide (COM (2016) 148 final).

¹⁷⁹⁸ Commission Work Programme 2017: Delivering a Europe that protects, empowers and defends, COM (2016) 710 final; <https://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1487237841093&uri=CELEX:52016DC0710>. Both the Council and the European Parliament welcomed these initiatives — see: <http://www.consilium.europa.eu/en/press/press-releases/2016/05/25-conclusions-vat-action-plan/>; European Parliament Resolution of November 24, 2016 on Towards a definitive VAT system and fighting VAT fraud (2016/2033(INI)) (<http://www.europarl.europa.eu/sides/getDoc.do?type=TA&language=EN&reference=P8-TA-2016-0453>) and Council conclusions of November 8, 2016 on Improvements to the current EU VAT rules for cross-border transactions (No. 14257/16 FISC 190 ECOFIN 1023 of November 9, 2016). <http://data.consilium.europa.eu/doc/document/ST-14257-2016-INIT/en/pdf>.

¹⁷⁹⁹ COM (2017) 569 final 2017/0251 (CNS); see also (SWD (2017) 325 final) and (SWD (2017) 326 final).

¹⁷⁹⁶ https://taxation-customs.ec.europa.eu/news/vat-digital-age-implementation-strategy-support-businesses-and-member-states-2025-09-24_en.

have applied since January 1, 1993, with a definitive VAT system for intra-EU B2B trade, under which domestic and cross-border transactions in goods will be treated in the same way.¹⁸⁰⁰

Under the 2017 Proposed Directive, the definitive system replaces, with one taxable supply of goods located for VAT purposes in the Member State of destination (the “intra-EU supply of goods”), the current transitional arrangements, which entail an exempt supply of goods in the Member State of departure and a taxed intra-EU acquisition in the Member State of destination, for which the acquirer is the person liable to VAT.

Within the context of that system, the concept of “certified taxable person” (CTP), i.e., a taxable person with an attestation to the effect that it can globally be considered a reliable taxpayer,¹⁸⁰¹ is to play an essential role in that certain simplification rules, which may potentially be fraud-sensitive, will apply only where a certified taxable person is involved in the relevant transaction.

CTP status would require that: (i) the taxable person has its head office or fixed establishment in the European Union; (ii) the taxable person is involved in intra-EU trade or is the supplier or the customer in a call-off stock arrangement; (iii) there is no serious infringement or repeated infringements of the taxation rules or the customs legislation and no record of serious criminal offences relating to the economic activity of the taxable person; (iv) the taxable person demonstrates a high level of control of its operations and of the flow of the goods by means of a system managing commercial and, where appropriate, transportation records (i.e., the system must allow appropriate tax controls by means of a reliable or certified audit trail); and (v) there is evidence that the taxable person is financially solvent (this can be proven by good financial standing or the taxable person can provide guarantees from insurance or other financial institutions or other economically reliable third parties).

The CTP concept should also allow for a gradual implementation of the definitive VAT system because, in the first step of that system, the reverse charge (i.e., the liability to VAT of the acquirer and not the supplier, which gives rise in practice to a situation similar to that which currently exists under the transitional arrangements) will apply where the acquirer, in the case of an intra-EU supply,¹⁸⁰² is a certified taxable person. The supplier will be liable for payment of the VAT on this “intra-EU supply,” unless the acquirer is a certified taxable person, in which case the certified taxable person will account for the VAT in its VAT return. Where the person liable for VAT is not established in the Member State in which the tax is due, it will be able to settle its declaration and payment obligations via an

OSS system (see, the discussion at XVII.L.6., above). It will also be possible to use that system for purposes of the deduction of input VAT.

The 2017 Proposed Directive was followed, on May 25, 2018, by a Proposal for a Council Directive amending the VATD as regards the introduction of the detailed technical measures for the operation of the definitive VAT system for the taxation of trade between Member States (the “2018 Proposed Directive”).¹⁸⁰³ This represents a second sub-step towards a definitive VAT system based on the principle of taxation in the Member State of destination, supplementing the 2017 Proposed Directive and setting out the detailed arrangements for putting the 2017 Proposed Directive cornerstones in place with respect to intra-EU B2B supplies of goods.¹⁸⁰⁴ The extension of the definitive VAT system to the supply of services is scheduled to follow the first evaluation of the implementation of the new VAT system for the intra-EU B2B supply of goods.

In other words, in the Commission’s view, the realization of the definitive VAT system for B2B transactions is to be organized in two legislative steps, the first step addressing the VAT treatment of intra-EU B2B supplies of goods (i.e. the subject-matter of, respectively, the 2017 Proposed Directive (first sub-step) and the 2018 Proposed Directive (second sub-step)), and the second step addressing supplies of services.

Proposed key measures under the 2017 and 2018 Proposals, when read together, may be summarized, as follows:

(i) Intra-EU supplies: the current VAT system splits the cross-border B2B supply of goods into two different transactions for VAT purposes: an exempt supply in the Member State of departure of the goods and an intra-EU acquisition taxed in the Member State of destination. It is proposed that a cross-border B2B supply of goods within the European Union would give rise to a single transaction for VAT purposes: an intra-EU supply of goods. Consequently, the concept of an intra-EU acquisition of goods as a transaction subject to VAT is to be removed from Articles 2 to 4 of the Common VAT System Directive (CVSD), as well as all subsequent provisions within the VATD related to that concept. A point (3) would be added to paragraph 4 of Article 14 of the VATD, which contains a definition of intra-EU supplies of goods. The “intra-EU supply of goods” will mean a supply of goods made by a taxable person for a taxable person or for a non-taxable legal person (for example, a public authority) whereby the goods are dispatched or transported, by or on behalf of the supplier or the person acquiring the goods within the European Union, from one Member State to another.

(ii) Place of supply: the general rules for determining the place of supply of goods without transport (the place where the goods are located at the time the supply takes place) and the place of supply of goods with transport (the place where the goods are located when the dispatch of the goods or transport begins) remain. However, a new exception to the general rule is proposed, following which the

¹⁸⁰⁰ Although currently not in the forefront of the work on the definitive VAT system, in the future there may be a need to assess certain customs procedures (e.g., CP 42) so as to ensure this principle is coherently applied in combination with import/export schemes. Incidentally, a fundamental reform of the EU Customs Union is on the agenda of the Commission (see, to that effect, the May 17, 2023 proposals put forward by the Commission).

¹⁸⁰¹ Compare with the status of Authorized Economic Operator (AEO) under the Union Customs Code (UCC) rules.

¹⁸⁰² The 2017 Proposed Directive introduces the concept of an “intra-EU supply” as a new concept in relation to goods. This new single taxable event is intended to replace the current system of an exempt supply in the Member State of departure and a taxed “intra-EU acquisition” in the Member State of destination as a second and separate taxable event. Under this new concept, the “place of supply” will be situated in the Member State of arrival of the goods.

¹⁸⁰³ COM (2018) 329 final, 2018/0164 (CNS).

¹⁸⁰⁴ The Commission points out that the 2018 Proposed Directive will need to be complemented by a proposal for amending Regulation (EU) 904/2010 on Administrative Cooperation in the field of value added tax.

place of supply of an intra-EU supply of goods would be deemed to be the place where the goods were located at the time when the dispatch or transport of the goods to the customer ended. A supply would qualify as an intra-EU supply only if it were linked to the cross-border transportation of goods by the supplier or the purchaser. Hence, under the definitive VAT regime, it would be important to allocate transport to a specific supply in the case of chain transactions. All supplies preceding or following the intra-EU supply would be taxed as domestic supplies, either in the country of dispatch or the country of arrival. The simplification rule for triangular supplies would cease to exist. The current thresholds under which cross-border supplies of goods to non-taxable legal persons or to fully exempt taxable persons are taxed in the country of dispatch would be abolished, and the taxation of these supplies at destination as intra-EU supplies would apply in all cases. Certain types of supplies (for example, supplies of goods that are assembled or installed, with or without a trial run) would not fall within the scope of the new rules for intra-EU supplies, but would remain subject to their own specific place-of-supply rules. Transfers of own goods by a business from one Member State to another would be assimilated to an intra-EU supply in the same way as they are currently assimilated to an intra-EU transaction. The taxable person completing such a transfer would have to self-assess VAT in the country of arrival.

(iii) Chargeability of tax: a single rule for the chargeability of VAT on intra-EU supplies would apply, under which VAT would become chargeable on issue of an invoice or on the expiration of the time limit referred to in the first paragraph of Article 222 if no invoice had been issued by that time (i.e., the 15th day of the month following that in which the chargeable event occurred).

(iv) Persons Liable to Pay VAT — CTPs: the principle laid down in Article 193 of the CVSD that VAT is payable by any taxable person carrying out a taxable supply of goods or services would remain, unless another provision in the same article stipulates that VAT is payable by another person. By way of exception to that principle, VAT would be payable by the person to whom the goods are supplied insofar as he or she is a CTP if the goods were supplied by a taxable person not established within the territory of the Member State in which the VAT was due. The concept of “certified taxable person” was included in the 2017 Proposed Directive (see above). As regards intra-EU supplies of goods, the combination of these rules would mean that the supplier would in principle be liable for the payment of the VAT in the Member State of arrival of the goods, unless the supplier were not established in the Member State of taxation and the customer were a CTP. In the latter case, the customer would pay the VAT due by way of reverse charge in the Member State of arrival of the goods. To achieve consistent VAT treatment based on the principle of effectively charging VAT (unless a CTP is involved), Member States would no longer have the option of applying domestic reverse charge rules for supplies of goods. As such, domestic reverse charge rules would be aligned with the rules on cross-border supplies, i.e., non-

established suppliers would apply a reverse charge only if their customer qualified as a CTP. This change regarding the VAT liability on domestic sales by non-established suppliers could have a positive effect in chain transactions where all parties after the initial supplier are CTPs, since in that case entire chains could be not charged with VAT.

(v) Single Union OSS: as announced in the 2017 Proposed Directive, an online reporting mechanism or “One-Stop Shop” system would be introduced to allow the declaration, payment and deduction of VAT for all B2B goods transactions of traders operating in the European Union. The 2018 Proposed Directive describes this system in detail. Technically, the OSS system would be an extension of the intra-EU OSS system that has applied since January 1, 2021 for the declaration and payment of VAT on EU distance sales (cross-border B2C sales) by EU or non-EU taxable persons. It would allow the reporting of supplies of goods on which VAT is payable by the supplier or the buyer, and the claiming of deductible VAT, in a single portal in the Member State of establishment of an EU-based business or, in the case of a non-EU based business, in a Member State in which an intermediary has been appointed to allow the supplier to benefit from the regime. The system would allow the deduction of input VAT incurred outside the home country; however, this would be limited to the VAT of Member States in which the business had (within a certain timeframe) taxable outgoing transactions reportable in the OSS return. If there are no such transactions, a taxable person would have to rely on the traditional refund procedures provided for by the VAT legislation. In principle, the OSS return would have to be filed quarterly, but a monthly filing would be required for companies with an overall EU turnover in excess of 2.5 million euros.

As noted above, progress on the 2017 and 2018 Proposals has been slow to nonexistent. Odds are, therefore, that the definitive VAT system, at least in the form as currently on the table, may well be stillborn. Incidentally, in its 2025 Working Programme, the Commission included the 2018 Proposal in Annex IV: Withdrawals, with as comment: “No foreseeable agreement — discussions are suspended since 2019 and further progress is unlikely”.

Confronted with the lengthy and cumbersome progress towards a definitive VAT system, the end-result of which remains uncertain, the Commission on October 4, 2017 proposed a number of “quick fixes” that were subsequently codified in Council Directive (EU) 2018/1910, Council Implementing Regulation (EU) 2018/1912 and Council Regulation (EU) 2018/1909 (all dated December 4, 2018) and entered into force on January 1, 2020 (the “2020 Quick Fixes”). The 2020 Quick Fixes concerned EU VAT changes with respect of call-off stock arrangements (see XVII.D.1.a.(4), K.4. and K.6., above), chain transactions (see XVII.E.2.b.(4), above) and the exemption for intra-EU supplies of goods (see XVII.I.3.a.(1), above). This was followed, on March 11, 2025, by the Council adopting the VAT in the Digital Age (ViDA) Package (see, XVII.O., above).

3. *Distance Sales*

By way of a reminder (see XVII.D.1.a.(2), above), on May 17, 2023, the Commission, as part of a broad and comprehensive reform of the Customs Union, tabled a Proposal for a Council Directive amending Directive 2006/112/EC as regards VAT rules relating to taxable persons who facilitate distance sales of imported goods and the application of the special scheme for distance sales of goods imported from third territories or third countries and special arrangements for declaration and payment of import VAT.¹⁸⁰⁵

The Proposal suggests three changes: (i) the removal of the 150-euro threshold, rendering all distance sales of imported goods, regardless of their value, eligible for the IOSS; (ii) an extension of the deemed supplier rule to all distance sales of imported goods, including those with a value of more than 150 euros, that are facilitated by an electronic interface; and (iii) an extension of the application of the “special arrangements” (see XVII.L.4., above) by the removal of the 150-euro threshold. If adopted “as is” as a Directive, Member States would have to apply the new rules as of March 1, 2028.

¹⁸⁰⁵ COM/2023/262 final.

XVIII. Excise Duties

A. Legislative Framework

Executive Summary

This Section provides an overview of the EU legislative framework that governs harmonized excise duties. That framework comprises a general directive (the “Horizontal Directive”) and four “product-specific” directives (i.e., covering manufactured tobacco, alcohol and alcoholic beverages (two directives), and energy products and electricity (XVI-II.A., below)).

The Section then proceeds to a discussion of the Horizontal Directive and each of the product-specific directives (highlighting, where applicable, the future prospects for those directives) (XVIII.B. and XVIII.C., below). The Section ends with a discussion of administrative cooperation in the field of excise duties (XVIII.D., below).

Excise duties are indirect taxes on the consumption or use of certain goods. In contrast to value added tax (VAT), which is a general *ad valorem* tax, excise duties only apply to certain product categories (“excise goods”) and are mostly imposed as an amount of money per quantity (although, in certain cases, they may also be based on the *ad valorem* principle (retail or wholesale price) or on both quantity and price (for example, in the case of cigarettes — see below)).

The current legislative framework governing EU harmonized excise duties comprises:

- (i) A general Directive; and
- (ii) Four “product-specific” Directives.

Council Directive 2008/118/EC of December 16, 2008, concerning the general arrangements for excise duty (which repealed and replaced Council Directive 92/12/EEC of February 25, 1992, on the general arrangements for products subject to excise duty and the holding, movement and monitoring of such products) was the initial directive setting out the general arrangements in relation to excise duty levied directly or indirectly on the consumption of “excise goods,” i.e.:

- (i) Manufactured tobacco;
- (ii) Alcohol and alcoholic beverages; and
- (iii) Energy products and electricity.

It has been substantially amended on a number of occasions and was recast in the interests of clarity by Council Directive (EU) 2020/262 of December 19, 2019, laying down the general arrangements for excise duty (recast) (the “Horizontal Directive.”)¹⁸⁰⁶ (See XVIII.B., below.)

¹⁸⁰⁶ Council Directive (EU) 2020/262 entered into force on March 18, 2020. Member States were to transpose the substantive measures of the Directive by December 31, 2021 at the latest and to apply those measures as from February 13, 2023 onwards. See also Commission Delegated Regulation (EU) 2022/1636 of July 5, 2022 supplementing Council Directive (EU) 2020/262 by establishing the structure and content of the documents exchanged in the context of the movement of excise goods, and establishing a threshold for losses due to the nature of the goods; Commission Implementing Regulation (EU) 2022/

The “product-specific” Directives, designed to harmonize the structures and the approximation of the rates of the excise duties that are the subject-matter of the Horizontal Directive, are:

(i) Council Directive 2011/64/EU of June 21, 2011, concerning the structure and rates of excise duty applied to manufactured tobacco (which codified, and hence repealed, Council Directives 92/79/EEC, 92/80/EEC and 95/59/EC);

(ii) Council Directive 92/83/EEC of October 19, 1992, on the harmonization of the structures of excise duties on alcohol and alcoholic beverages (as amended by Council Directive (EU) 2020/1151 of July 29, 2020 amending Directive 92/83/EEC, on the harmonization of the structures of excise duties on alcohol and alcoholic beverages);

(iii) Council Directive 92/84/EEC of October 19, 1992, on the approximation of the rates of excise duty on alcohol and alcoholic beverages;¹⁸⁰⁷ and

(iv) Council Directive 2003/96/EC of October 27, 2003, restructuring the Community framework for the taxation of energy products and electricity (which repealed Council Directives 92/81/EEC and 92/82/EEC and replaced the excise duty on mineral oils with the taxation of energy products including coal, natural gas and electricity) (see XVI-II.C., below).

In addition, administrative cooperation between the Member States in the field of excise duties is governed by Council Regulation (EU) No. 389/2012 of May 2, 2012 (see XVIII.D., below).

B. Horizontal Directive

1. General Provisions

The Horizontal Directive sets out the general arrangements in relation to excise duty levied directly or indirectly on the consumption of “excise goods,” i.e.:

- (i) Manufactured tobacco;
- (ii) Alcohol and alcoholic beverages; and
- (iii) Energy products and electricity.¹⁸⁰⁸

In contrast to the harmonized VAT system, the general arrangements for excise duties falling within the scope of the Horizontal Directive are definitive.

1637 of July 5, 2022 laying down rules for the application of Council Directive (EU) 2020/262 as regards the use of documents in the context of the movement of excise goods under a duty suspension arrangement and of the movement of excise goods after release for consumption, and establishing the form to be used for the exemption certificate.

¹⁸⁰⁷ Under the terms of the Northern Ireland Protocol, these two Directives continued to apply in Northern Ireland after the UK’s exit from the EU. The February 2023 Windsor Framework in conjunction with EU-UK Joint Committee Decision No. 1/2023 of March 24, 2023 revisited this position in allowing the UK Government to apply its alcohol duty rates UK-wide, provided that duty rates in Northern Ireland do not fall below the EU minima set by the Directive 92/84/EEC.

¹⁸⁰⁸ Council Directive 2008/118/EC of December 16, 2008, concerning the general arrangements for excise duty (Horizontal Directive,) Art. 1.1.

Excise goods are subject to excise duty at the time of their production, including — where applicable — their extraction, within the territory of the European Union or their importation or their irregular entry into the territory of the European Union.¹⁸⁰⁹

Member States are allowed to levy other indirect taxes on excise goods for specific purposes,¹⁸¹⁰ provided those taxes comply with the EU tax rules applicable to excise duty or VAT as far as the determination of the tax base, the calculation of the tax, and the chargeability and monitoring of the tax are concerned, but not the provisions on exemptions.¹⁸¹¹

This condition does not, however, require Member States to comply with all the rules applicable for excise duty or VAT purposes as far as the following are concerned:

- (i) The determination of the tax base;
- (ii) The calculation of the tax;
- (iii) The chargeability of the tax; and
- (iv) The monitoring of the tax.

It is sufficient that the indirect taxes pursuing specific objectives should, on these points, accord with the general scheme of (i)–(iv) above, as structured by the EU legislation. In other words, non-harmonized duties must display the essential characteristics of the European law on excise duty.

Example (1): A duty on beverages will not satisfy the basic principles of excise law if its calculation is based on a feature not commonly used in excise law (e.g., the value of the goods as opposed to their weight, quantity or alcohol content).

Example (2): Charging duties when the goods concerned are sold to the end consumer would also contradict the general arrangement because, under excise law, duties are normally charged once the goods are released for consumption. There is also no structural similarity to VAT if

the duties are charged once the goods are sold to the end consumer without the possibility of deductions.¹⁸¹²

In addition, Member States are allowed to levy taxes on products other than excise goods and on the supply of services, including taxes relating to excise goods, that cannot be characterized as turnover taxes in the context of trade between Member States.

However, the levying of such taxes may not give rise to formalities connected with the crossing of frontiers.¹⁸¹³ This limitation is logical having regard to the prohibition on customs duties and charges having equivalent effect to customs duties set forth in Article 30 of the Treaty on the Functioning of the European Union (TFEU).¹⁸¹⁴

Whether a national tax constitutes:

- (i) “Another indirect tax on excise goods levied for specific purposes;” or
- (ii) “A tax on the supply of services relating to excise goods”

must be determined having regard to the predominant feature of the transactions on which the national tax at issue is imposed.¹⁸¹⁵

A tax on the supply of services relating to excise goods cannot be characterized as a turnover tax where it applies only to a defined category of products (for example, alcoholic beverages).¹⁸¹⁶

Article 3 sets forth a number of definitions for the purposes of the Horizontal Directive, as well as its implementing provisions. The main definitions are addressed, to the extent relevant, in the discussion below.

The territorial application of the Horizontal Directive is to a large extent similar to that of VAT.¹⁸¹⁷

As regards illegal transactions, in the same vein as for VAT purposes, the mere fact that conduct amounts to an offence does not entail exemption from excise duty. Such an exemption applies only in specific circumstances where, owing to the special characteristics of certain goods (for example, nar-

¹⁸⁰⁹ Horizontal Directive, Art. 6(2).

¹⁸¹⁰ Duties levied for purely fiscal reasons or as a means of reinforcing financial autonomy do not pass the test (Case C-437/97, *EKW and Wein & Co*; see Case C-82/12, *Transportes Jordi Besora*: a tax on the retail sale of mineral oils (in the case at issue a tax on retail sales of certain hydrocarbons (*Impuesto sobre las Ventas Minoristas de Determinados Hidrocarburos*)) cannot be regarded as a tax pursuing a specific purpose where that tax, intended to finance the exercise by the regional or local authorities concerned of their powers in the fields of health and the environment, is not itself directed at protecting health and the environment).

¹⁸¹¹ Horizontal Directive, Art. 1(2). In Case C-255/20, *Agenzia delle dogane e dei monopoli — Ufficio delle dogane di Gaeta*, the CJEU held (by way of Order) an Italian regional tax on the sale of petrol for motor vehicles to be incompatible with Horizontal Directive, Art. 1(2) as the proceeds of that tax were intended solely as a general contribution to the budget of the local authorities; such tax cannot be regarded as pursuing a “specific purpose” within the meaning of that provision. This is in line with the Court’s previous case-law (see, e.g., Case C-553/13, *Statoil Fuel & Retail*; Case C-82/12, *Transportes Jordi Besora*). See also Case T-653/24, *Accorinvest and Société Générale*, where the General Court (now competent to hear cases in the excise duty area) held that a legal mechanism allowing a tax to be passed on does not in itself create a direct link with electricity consumption and that a levy based only on fixed network access charges, independent of actual use, is not an “other indirect tax” on excise goods under EU law.

¹⁸¹² See, e.g., Case C-434/97, *Commission v. France*; Case C-437/97, *EKW and Wein & Co*. See also Case C-553/13, *Statoil Fuel & Retail*, in which the CJEU held that Art. 1(2) precludes a tax, insofar as it is levied on retail sales of liquid fuel subject to excise duty, from being regarded as having a specific purpose within the meaning of that provision where that tax is intended to finance the organization of public transport within the territory of the authority imposing the tax and where that authority is required to undertake and finance such transport irrespective of the existence of that tax, even if the revenue from that tax has been used solely for purposes of performing that activity.

¹⁸¹³ Horizontal Directive, Art. 1(3). The words “on products other than excise goods” in Art. 1(3) imply that the provision is necessarily concerned with taxation of goods outside the harmonized catalogue of products. The CJEU considers Art. 1(3) to have direct effect allowing individuals to rely on it before a national court in a dispute between them and a Member State — see, Case C-402/14, *Viamar*.

¹⁸¹⁴ See II.; see also Case C-313/05, *Brzeziński*; Case C-2/09, *Kalinchev*.

¹⁸¹⁵ Case C-231/94, *Faaborg-Gelting Linien*; see, e.g., Case C-491/03, *Hermann*: a tax levied on the supply of alcoholic beverages to customers in a catering context must be regarded as a tax levied on the supply of services relating to products subject to excise duty within the meaning of Horizontal Directive, Art. 1(3)(b).

¹⁸¹⁶ Case C-491/03, *Hermann*; see also Case 252/86, *Bergandi*, Case C-437/97, *EKW and Wein & Co* and Case C-308/01, *GIL Insurance and Others*.

¹⁸¹⁷ Horizontal Directive, Arts. 4 and 5. See XVII.B., above.

cotics), any competition between a lawful economic sector and an unlawful sector is precluded. This is not the case for excise goods that are intrinsically lawful products with respect to which contraband trade and trade in lawful economic channels cannot be ruled out, in that there is a lawful market for excise goods that is precisely the target of contraband products. Consequently, in such circumstances, the provisions on (liability to) excise duty apply also to illegal importation into the EU customs territory or illegal delivery within that territory of excise goods.¹⁸¹⁸

2. Chargeability of Excise Duty, Reimbursement and Remission, and Exemptions

a. Time and Place of Chargeability

While excise goods are subject to excise duty at the time of their production, including, where applicable:

(i) Their extraction within; or

(ii) Their importation or irregular entry into,

EU territory (see XVIII.B.1., above), the duty (only) becomes chargeable at the time, and in the Member State, of release for consumption.¹⁸¹⁹

“Release for consumption” means:

(i) The departure of excise goods, including irregular departure, from a duty suspension arrangement;

(ii) The holding or storage of excise goods, including cases of irregularity, outside a duty suspension arrangement where excise duty has not been levied under the applicable provisions of EU law and national legislation;

(iii) The production, including the processing, of excise goods and irregular production or processing outside a duty suspension arrangement; or

(iv) The importation of excise goods, unless the excise goods are placed, immediately on importation, under a duty suspension arrangement, or the irregular entry of excise goods, unless (in certain cases) the customs debt was extinguished.¹⁸²⁰

It follows that the mere holding of a product subject to excise duty constitutes a release for consumption where duty has not yet been levied on that product under the applicable provisions of EU law and national legislation.¹⁸²¹

For these purposes, “duty suspension arrangement” refers to a tax arrangement applied to:

(i) The production;

(ii) The processing;

(iii) The holding;

(iv) The storage; or

(v) The movement

of excise goods under which excise duty is suspended.¹⁸²²

Goods seized by the local customs and tax authorities on their introduction into the territory of the European Union and simultaneously or subsequently destroyed by those authorities, without having left their possession, must be regarded as not having been imported into the European Union, with the result that the chargeable event for excise duty on such goods does not occur.

However, where goods are seized after their unlawful introduction into the territory of the European Union (i.e., once they have gone beyond the area in which the first customs office inside that territory is situated) and simultaneously or subsequently destroyed by the authorities, without having left their possession, the chargeable event for excise duty on the goods occurs and, consequently, the excise duty on them becomes chargeable.¹⁸²³

The total destruction or irretrievable loss, whether total or partial, of excise goods under a duty suspension arrangement (i.e., when the goods are rendered unusable as excise goods) as a result of unforeseeable circumstances or *force majeure*, or as a consequence of authorization by the competent authorities of the relevant Member State, is not considered a release for consumption.¹⁸²⁴

Under Article 6(7) of Directive (EU) 2020/262, partial loss due to the nature of the goods that occurs during a duty suspension movement between the Member States is not to be considered a release for consumption insofar as the amount of loss falls below the common partial loss threshold for those excise goods, unless a Member State has reasonable cause to suspect fraud or irregularity.¹⁸²⁵

Under Article 45(2), in the event of partial loss due to the nature of the goods that occurs during their transport in the territory of a Member State other than the Member State in which they were released for consumption, excise duty is not chargeable in that Member State where the amount of loss falls within the relevant common partial loss threshold, unless a Member State has reasonable cause to suspect fraud or irregularity.

Example: Taking into account the nature of manufactured tobacco products, their physical and chemical characteristics and the existing national thresholds, the common partial loss threshold for manufactured tobacco is set at 0%.

Derogatory rules apply to determine the time and place of release for consumption in the case of “irregularities.” “Irregularities” means situations occurring during a movement of excise goods under a duty suspension arrangement (other than the total destruction or irretrievable loss of the goods) as a result of which a movement, or a part of a movement, of excise goods has not been completed in accordance with Article 20(2) because the consignee has not taken delivery of the excise goods or the goods have not left EU territory.¹⁸²⁶

¹⁸¹⁸ Case C-455/98, *Salumets and Others* (smuggling of ethyl alcohol).

¹⁸¹⁹ Horizontal Directive, Art. 6(2).

¹⁸²⁰ Horizontal Directive, Art. 6(3).

¹⁸²¹ Case C-325/99, *van de Water*.

¹⁸²² Horizontal Directive, Art. 3(6).

¹⁸²³ Case 230/08, *Dansk Transport*. The reason is that in the latter case the excise duty on the goods is not to be deemed to have been placed under a suspension arrangement (see XVIII.B.3., below).

¹⁸²⁴ Horizontal Directive, Art. 6(5).

¹⁸²⁵ Horizontal Directive, Art. 6(7).

¹⁸²⁶ Horizontal Directive, Art. 9.

b. Person Liable to Pay Excise Duty

The person liable to pay the excise duty that has become chargeable is, respectively:

(i) In relation to the departure of excise goods from a duty suspension arrangement:

- The authorized warehouse keeper;¹⁸²⁷
- The registered consignee,¹⁸²⁸ or any other person releasing the excise goods or on whose behalf the excise goods are released from the arrangement and,
- In the case of irregular departure from the tax warehouse, any other person involved in that departure; or,
- In the case of irregularity during a movement of excise goods under a duty suspension arrangement:
 - The authorized warehouse keeper;
 - The registered consignor;
 - Any other person that guaranteed the payment of the excise duty (which may be the authorized warehouse keeper of dispatch or the registered consignor);¹⁸²⁹
 - The transporter or carrier, the owner of the excise goods;
 - The consignee;
 - Two or more of these persons acting jointly;¹⁸³⁰ and
 - Any person that participated in the irregular departure and that was aware, or ought reasonably to have been aware, of the irregular nature of the departure;

(ii) In relation to the holding of excise goods:

- The person holding the excise goods; and
- Any other person involved in the holding of the excise goods;

(iii) In relation to the production of excise goods:

- The person producing the excise goods;

¹⁸²⁷ “Authorized warehouse keeper” means a natural or legal person authorized by the competent authorities of a Member State, in the course of its business, to produce, process, hold, receive or dispatch excise goods under duty suspension arrangements in a tax warehouse (Horizontal Directive, Art. 3(1)). “Tax warehouse” means a place where excise goods are produced, processed, held, received or dispatched under duty suspension arrangements by an authorized warehouse keeper in the course of its business, subject to certain conditions laid down by the competent authorities of the Member State in which the tax warehouse is located (Horizontal Directive, Art. 3(11)).

¹⁸²⁸ “Registered consignee” means a natural or legal person authorized by the competent authorities of the Member State of destination, in the course of its business and subject to the conditions established by those authorities, to receive excise goods moving under a duty suspension arrangement from another Member State (Horizontal Directive, Art. 3(9)).

¹⁸²⁹ “Registered consignor” means a natural or legal person authorized by the competent authorities of the Member State of importation, in the course of its business and subject to the conditions established by those authorities, only to dispatch excise goods under a duty suspension arrangement on their release for free circulation in accordance with (now) UCC Regulation, Art. 201 discussed in XIX.D.1., below. (Horizontal Directive, Art. 3(10)).

¹⁸³⁰ See Horizontal Directive, Art. 7(2).

- Any other person involved in their production (in the case of irregular production); and

(iv) In relation to the importation of excise goods:

- The person that declares the excise goods;
- The person on whose behalf they are declared on importation; and
- In the case of irregular importation, any other person involved in the importation.¹⁸³¹

Where a number of persons are liable for payment of one excise duty debt, they are jointly and severally liable for such debt.¹⁸³²

c. Chargeability Conditions and Rate of Excise Duty

The conditions for the chargeability and the rate of excise duty to be applied are those in force on the date on which the duty becomes chargeable in the Member State in which release for consumption takes place.¹⁸³³

Excise duty is to be levied and collected and, where appropriate, reimbursed or remitted in accordance with the procedure laid down by each Member State, subject to the proviso that Member States must apply the same procedures to national goods and those from other Member States.¹⁸³⁴ In other words, while the purpose of the rules governing the chargeability of the excise duty is to ensure that chargeability is identical in all the Member States,¹⁸³⁵ the EU legislature was clearly not seeking to harmonize the procedures for the levying and collection of duty by those States but, on the contrary, left it to them to determine those procedures, subject to the nondiscrimination requirement.¹⁸³⁶

d. Reimbursement and Remission of Excise Duty

Excise duty on excise goods that have been released for consumption may, at the request of a person concerned, be reimbursed or remitted by the competent authorities of the Member States in which those goods were released for consumption in the situations fixed by the Member States and in accordance with the conditions that Member States lay down for the purposes of preventing any possible evasion or abuse. However, reimbursement or remission may not give rise to exemptions other than those provided for in Article 11 (see XVIII.B.2.e., below) or the relevant “product-specific” Directives.¹⁸³⁷

e. Exemptions

Exemptions from excise duty are provided for goods that in principle should be subject to excise duty but are intended to be used:

- (i) In the context of diplomatic or consular relations;
- (ii) By qualifying international organizations;
- (iii) By certain armed forces; and

¹⁸³¹ Horizontal Directive, Art. 7(1)(d).

¹⁸³² Horizontal Directive, Art. 7(2).

¹⁸³³ Horizontal Directive, Art. 9(1).

¹⁸³⁴ Horizontal Directive, Art. 9(2).

¹⁸³⁵ Case C-296/95, *EMU Tabac and Others*.

¹⁸³⁶ Case C-325/99, *van de Water*.

¹⁸³⁷ Horizontal Directive, Art. 10.

(iv) For consumption under an agreement concluded with third countries or international organizations provided the agreement is allowed or authorized with regard to exemption from VAT.¹⁸³⁸

In addition, Member States may exempt from the payment of excise duty excise goods supplied by tax-free shops that are carried in the personal luggage of travelers to a third territory or third country taking a flight or sea-crossing.¹⁸³⁹

Goods supplied on board an aircraft or a ship during a flight or sea-crossing to a third territory or third country are to be treated in the same way as goods supplied by tax-free shops.¹⁸⁴⁰

For these purposes:

(i) “Tax-free shop” means any establishment situated in an airport or a port that fulfills the conditions laid down by the competent authorities of the Member States (specifically having regard to the obligation of Member States to take the measures necessary to ensure that the exemptions concerned are applied in such a way as to prevent any possible evasion, avoidance or abuse);¹⁸⁴¹ and

(ii) “Traveler to a third territory or to a third country” means any passenger holding a transport document, for air or sea travel, stating that the final destination is an airport or a port situated in a third territory or third country.¹⁸⁴²

3. Suspension Arrangements

Each Member State determines its rules concerning the production, processing and holding of excise goods, subject to the Horizontal Directive. The following activities where the excise duty has not been paid (i.e., under suspension of excise duty), must take place in a tax warehouse.¹⁸⁴³

- (i) Production of excise goods;
- (ii) Processing of excise goods; and
- (iii) Holding of excise goods.

A tax warehouse is a place where excise goods are:

- (i) Produced;
- (ii) Processed;
- (iii) Held;
- (iv) Received; or
- (v) Dispatched

under duty suspension arrangements by an authorized warehouse keeper in the course of its business, subject to certain conditions laid down by the competent authorities of the Member State in which the tax warehouse is located.¹⁸⁴⁴

The opening and operation of a tax warehouse by an authorized warehouse keeper is subject to the authorization of the competent authorities of the Member State in which the

tax warehouse is situated, such authorities being entitled to lay down conditions to prevent any possible evasion or abuse.¹⁸⁴⁵

The authorized warehouse keeper must meet certain requirements that may include, if necessary, the provision of a guarantee to cover the risk inherent in the production, processing and holding of excise goods.¹⁸⁴⁶

Thus, a suspension arrangement is a tax arrangement applied to the production, processing, holding and movement of products, where excise duty is being suspended. It is a feature of this arrangement that the excise duty is not yet payable on the products covered by it, although the chargeable event for taxation purposes has already taken place.¹⁸⁴⁷ Consequently, the arrangement postpones the chargeability of excise duty on the products subject to the duty until one of the conditions of chargeability is met. Where goods are:

(i) Seized after their unlawful introduction into the territory of the European Union, i.e., once they have gone beyond the area in which the first customs office inside that territory is situated; and

(ii) Simultaneously or subsequently destroyed by the competent authorities, without having left their possession, the excise duty on them is not to be deemed “to have been placed under a suspension arrangement” (with the result that the chargeable event for excise duty on such goods occurs and, consequently, the excise duty on them becomes chargeable).¹⁸⁴⁸

Excise goods may be moved under a duty suspension arrangement within the territory of the European Union, including where the goods are moved via a third country or a third territory:

(i) From a tax warehouse to another warehouse, a registered consignee, a place where the excise goods leave the territory of the European Union or an exempt consignee; or

(ii) From the place of importation to any of the above destinations where the goods are dispatched by a registered consignor,¹⁸⁴⁹ but only if such movements take place under the cover of a qualifying electronic administrative document.¹⁸⁵⁰

However, products subject to excise duty (for example, manufactured tobacco) that are manufactured from products not subject to excise duty (for example, raw tobacco) and imported into the European Union under the inward-processing procedure are to be deemed to be subject to duty suspension arrangements, despite the fact that they have become products subject to excise duty only by virtue of having been processed within EU territory, with the result that they can move between Member States without the competent authorities being entitled to insist on production of the administrative document referred to above.¹⁸⁵¹

¹⁸³⁸ Horizontal Directive, Art. 11.

¹⁸³⁹ Horizontal Directive, Art. 13(1).

¹⁸⁴⁰ Horizontal Directive, Art. 13(2).

¹⁸⁴¹ Horizontal Directive, Art. 13(3).

¹⁸⁴² Horizontal Directive, Art. 13(4).

¹⁸⁴³ Horizontal Directive, Art. 14.

¹⁸⁴⁴ Horizontal Directive, Art. 3(11).

¹⁸⁴⁵ Horizontal Directive, Art. 15(1).

¹⁸⁴⁶ Horizontal Directive, Art. 15(2).

¹⁸⁴⁷ Case C-395/00, *Cipriani*.

¹⁸⁴⁸ Case 230/08, *Dansk Transport*.

¹⁸⁴⁹ Horizontal Directive, Art. 16(1).

¹⁸⁵⁰ Horizontal Directive, Art. 20.

¹⁸⁵¹ Case C-550/08, *British American Tobacco (Germany)*.

The procedure to be followed on a movement of excise goods under suspension of excise duty is set out in Articles 20 to 28 of the Horizontal Directive, as further implemented by:

(i) Commission Delegated Regulation (EU) 2022/1636 of July 5, 2022 supplementing Council Directive (EU) 2020/262 by establishing the structure and content of the documents exchanged in the context of the movement of excise goods, and establishing a threshold for losses due to the nature of the goods; and

(ii) Commission Implementing Regulation (EU) 2022/1637 of July 5, 2022 laying down the rules for the application of Council Directive (EU) 2020/262 as regards the use of documents in the context of the movement of excise goods under a duty suspension arrangement and of the movement of excise goods after release for consumption, and establishing the form to be used for the exemption certificate.

A Member State may:

(i) Establish simplified procedures with respect to movements of excise goods under a duty suspension arrangement that take place entirely on its territory, including the possibility of waiving the requirement of electronic supervision of such movements; and

(ii) Enter into simplified procedure agreements with other Member States for the purposes of frequent and regular movements of excise goods (including via fixed pipelines) under a duty suspension arrangement between their respective territories.¹⁸⁵²

4. *Movement and Taxation of Excise Goods After Release for Consumption*

As discussed in XVIII.B.2.a., above, it is — in principle — not until the release for consumption of the excise good concerned that the excise duty (provided for by the relevant “product-specific” Directive) becomes chargeable.

Articles 32 through 47 of the Horizontal Directive set out the applicable rules, distinguishing between various movements of excise goods after release for consumption, i.e.:

- (i) Acquisition by private individuals;
- (ii) Holding in another Member State;
- (iii) Distance selling;
- (iv) Destruction and loss; and
- (v) Irregularities during the movement of excise goods.

5. *Marking*

A Member State may require that excise goods carry tax markings or national identification marks used for fiscal purposes at the time when the goods are released for consumption in its territory or, in cases provided for in:

- (i) Article 33(1) (excise goods held in another Member State); and

- (ii) Article 44(1) (distance selling), when the goods enter its territory.¹⁸⁵³

Any Member State that requires the use of tax markings or national identification marks is obliged to make them available to authorized warehouse keepers of other Member States. However, each Member State may require that these markings or marks be made available to a tax representative authorized by the competent authorities of that Member State.¹⁸⁵⁴

Without prejudice to any national provisions designed to ensure the proper implementation of marking and to prevent any evasion, avoidance or abuse, tax markings or national identification marks should not create obstacles to the free movement of excise goods.¹⁸⁵⁵

Where such markings or marks are affixed to excise goods, any amounts paid or guaranteed to obtain such markings or marks, apart from the fees for issuing them, are reimbursed, remitted or released by the Member State that issued them if excise duty has become chargeable and has been collected in another Member State.¹⁸⁵⁶

A Member State that has issued tax markings or national identification marks used for fiscal purposes may subject the reimbursement, remittance or release of the amount paid or guaranteed to the presentation of evidence, to the satisfaction of its competent authorities, that they have been removed or destroyed,¹⁸⁵⁷ a position underscored by the Court of Justice of the European Union (CJEU).

According to the CJEU,¹⁸⁵⁸ tax markings have an intrinsic value that distinguishes them from straightforward documents representing the payment of a sum of money to the tax authorities in the Member State in which the markings were issued.

In the case of loss, markings are capable of being used for unlawful purposes since their mere presence on the products subject to excise duty constitutes a presumption that excise duties have been paid in the Member State in which the markings were issued and, consequently, permits them to be marketed in that Member State. Thus, when an economic operator that has obtained tax markings is not able to furnish evidence that the markings will not be used to market products subject to excise duty in the Member State in which the markings were issued, that Member State has a legitimate interest in refusing to reimburse the amount paid.

National law allowing the purchaser of tax markings to obtain reimbursement simply by claiming that the markings had gone missing would likely encourage abuse and evasion, the prevention of which is precisely one of the objectives pursued by EU law. Accordingly, national rules that place the financial responsibility on the purchaser when tax markings go missing contribute to the achievement of the aim of preventing the fraudulent use of those markings and do not exceed what is necessary to pursue that objective, since they do not exclude any possibility of reimbursement or offsetting in other situations, such as the loss of markings due to accident or *force majeure*.

¹⁸⁵³ Horizontal Directive, Art. 47(1).

¹⁸⁵⁴ Horizontal Directive, Art. 47(2).

¹⁸⁵⁵ Horizontal Directive, Art. 47(3), first para.

¹⁸⁵⁶ Horizontal Directive, Art. 47(3), second para.

¹⁸⁵⁷ Horizontal Directive, Art. 47(3), third para.

¹⁸⁵⁸ Case C-494/04, *Heintz van Landewijck*; Case C-374/06, *BATIG*.

¹⁸⁵² Horizontal Directive, Arts. 30 and 31.

Consequently, when products released for consumption in a first Member State and thus carrying a tax marking of that Member State are intended to be consumed in another Member State and are dispatched to that Member State, it is not sufficient, to obtain reimbursement of the excise duty paid in the first Member State to establish that excise duty has been paid in the Member State of consumption. It is also necessary that the destruction of the tax markings of the first Member State be certified by the tax authorities of that State. It is apparent from the applicable provisions that the EU legislature favored the prevention of abuse and fraud to the detriment of the principle that taxation should occur in only one Member State.

In summary, according to the CJEU, the Horizontal Directive does not preclude legislation of a Member State that excludes the reimbursement of the amount paid to obtain tax markings issued by that Member State when the markings have been affixed to products subject to excise duty before being released for consumption in that Member State, when:

- (i) Those products have been stolen in another Member State, involving the payment of excise duties in that other Member State; and
- (ii) Evidence has not been furnished that the stolen products will not be marketed in the Member State that issued the markings.

Tax markings or national identification marks are valid in the Member State that issued them, but there may be mutual recognition of markings or marks between Member States.¹⁸⁵⁹

C. “Product-Specific” Directives

The “product-specific” Directives are aimed at the harmonization of the structures and the approximation of the rates of the excise duties that are the subject-matter of the Horizontal Directive, i.e.:

- (i) Manufactured tobacco;
- (ii) Alcohol and alcoholic beverages; and
- (iii) Energy products and electricity.

1. Manufactured Tobacco

a. General

The relevant legislative instrument is Council Directive 2011/64/EU of June 21, 2011 concerning the structure and rates of excise duty applied to manufactured tobacco (which codified, and therefore repealed, Council Directives 92/79/EEC, 92/80/EEC and 95/59/EC) (the “Tobacco Directive.”)¹⁸⁶⁰

The Tobacco Directive provides:

- (i) The common structure for excise duties on manufactured tobacco (by defining the various types of manufactured tobacco, distinguished by their characteristics and

by the way in which they are used, and by specifying the means of taxation);

- (ii) The minimum excise duty rates for all categories of manufactured tobacco beyond which Member States are free to fix their own national rates.

The harmonization of structures must result in competition in the different categories of manufactured tobacco belonging to the same group not being distorted by the effects of the charging of excise duties and, consequently, in the opening of the national markets of the Member States.¹⁸⁶¹

As regards prices and excise levels, for cigarettes (by far the most important category of tobacco products) and fine cut-tobacco intended for the rolling of cigarettes, there are still considerable differences between Member States that may disturb the operation of the internal market. The level of taxation is a major factor in the price of tobacco products, which, in turn, influences consumers’ smoking habits.

A certain degree of convergence between the tax levels applied in the Member States would help to:

- (i) Reduce fraud and smuggling within the European Union, which undermine tax-induced price levels, in particular of cigarettes and fine-cut tobacco intended for the rolling of cigarettes;
- (ii) Help to ensure a higher level of protection for human health.¹⁸⁶²

b. Definitions

Article 2 of the Tobacco Directive distinguishes between:

- (i) Cigarettes;
- (ii) Cigars and cigarillos; and
- (iii) Smoking tobacco, which includes:
 - (a) Fine-cut tobacco for the rolling of cigarettes; and
 - (b) Other smoking tobacco, different categories of which are covered in Articles 3 (cigarettes), 4 (cigars and cigarillos) and 5 (smoking tobacco).¹⁸⁶³

The relevance of the distinction between the various manufactured tobacco product categories is that they are subject to different tax rules. With regard to the distinction between “cigarettes” and “smoking tobacco,” the CJEU has indicated that it is apparent that the EU legislature intended to make a clear distinction between:

- (i) Manufactured “rolls” of tobacco, which are regarded as cigarettes; and,
- (ii) Smoking tobacco “intended for rolling cigarettes.”

¹⁸⁶¹ Council Directive 2011/64/EU of June 21, 2011 (“Tobacco Directive”), Recital (9).

¹⁸⁶² Tobacco Directive, Recitals (15) and (16).

¹⁸⁶³ Products containing no tobacco and used exclusively for medical purposes are not treated as manufactured tobacco. Herbal cigarettes, i.e., cigarettes without tobacco and consisting of herbs, in particular of the Labiatae family, presented and marketed as an aid to giving up smoking do not qualify for this exception where such cigarettes do not contain substances the combustion and inhalation of which produce scientifically recognized medical effects of a curative or preventive nature (Case C-495/04, *Smits-Koolhoven*).

¹⁸⁵⁹ Horizontal Directive, Art. 47(4).

¹⁸⁶⁰ See also, the (non-tax) Directive 2014/40/EU of the European Parliament and of the Council of April 3, 2014 on the approximation of the laws, regulations and administrative provisions of the Member States concerning the manufacture, presentation and sale of tobacco and related products and repealing Directive 2001/37/EC.

A clear material distinction is, therefore, established between tobacco already made up by the manufacturer into a unit of the size and shape of a cigarette, and loose tobacco that the smoker must coax into that form.

This finding is reinforced by legislative developments concerning taxes other than turnover tax on the consumption of manufactured tobacco, in which the EU legislature widened the definition of “cigarette,” adding to it, for example, “rolls of tobacco which, by simple non-industrial handling, are inserted into cigarette-paper tubes.”

It follows that making a cigarette from manufactured components involving easy, nonindustrial handling, consisting merely in inserting the component, in its aluminum wrapping, into a cigarette paper tube, and then pulling off the wrapping leaving the tobacco inside the tube, comes within the ambit of the excise duty treatment of “cigarettes” and not “smoking tobacco.”¹⁸⁶⁴

In *Eko-Tabak*,¹⁸⁶⁵ the CJEU emphasized that the definition of “smoking tobacco” could not be construed narrowly. It sufficed that two cumulative conditions were met:

- (i) That the tobacco was cut or otherwise split, twisted or pressed into blocks; and
- (ii) That the tobacco was capable of being smoked without further industrial processing.

There being no definition of the words “cut” and “split” in the directive, it is necessary to determine the scope of those words, to refer to their usual and everyday accepted meanings.¹⁸⁶⁶

The usual meaning of the words “cut” and “split” is very wide and they generally refer respectively, to:

- (i) The result of the process of removing a part or a piece of something with a sharp instrument; and
- (ii) The result of the process of breaking up or dividing something.

Consequently, insofar as the products at issue consist of tobacco leaves that have been partly stripped to remove the petiole, such products must be regarded as tobacco that has been cut or otherwise split, within the meaning of Article 5(1)(a) of the Tobacco Directive.

Concerning the concept of “industrial processing” used in Article 5(1)(a), this commonly refers to the transformation, usually on a large scale and by a standardized process, of raw materials into tangible goods. Simple handling intended to make an unfinished tobacco product capable of being smoked, such as merely inserting a roll of tobacco into a cigarette tube, is not “industrial processing.”¹⁸⁶⁷

Against this backdrop, dried, flat, irregular, partly stripped leaf tobacco and/or parts thereof that have undergone primary drying and controlled dampening, that contain glycerin and that are capable of being smoked after simple processing by means

of crushing or hand-cutting, fall within the definition of “smoking tobacco.”

Water-pipe tobacco, consisting of tobacco, which makes up 24% thereof, and other substances such as:

- (i) Sugar syrup;
- (ii) Glycerin;
- (iii) Flavorings; and
- (iv) Preservatives,

must be regarded as a product “consisting ... in part of substances other than tobacco” and as “smoking tobacco” and, hence, considered, in its entirety and irrespective of the substances other than tobacco contained therein, as smoking tobacco subject to the excise duty on tobacco.¹⁸⁶⁸

A natural or legal person established in the European Union that converts tobacco into manufactured products prepared for retail sale is deemed to be a manufacturer.¹⁸⁶⁹

c. Minimum Rates of Excise Duty

Articles 7 through 14 of the Tobacco Directive fix the minimum rates of excise duty, distinguishing between “cigarettes” (Articles 7–12) and other products (Articles 13–14).

d. Determination of Maximum Retail Selling Price; Collection of Excise Duty; Exemptions and Refunds

Manufacturers or, where appropriate, their representatives or authorized agents in the European Union and importers of tobacco from third countries are free to determine the maximum retail selling price for each of their products for each Member State in which the products in question are to be released for consumption.

However, this should not hinder the implementation of national systems of legislation regarding the control of price levels or the observance of imposed prices, provided they are compatible with EU legislation.¹⁸⁷⁰

The establishment by the public authorities of the Member States of a minimum price is incompatible with the freedom of manufacturers or, where appropriate, their representatives or authorized agents in the European Union and importers of tobacco from nonmember countries to determine the maximum retail selling price for each of their products.

The finding of incompatibility in such circumstances is intended to:

- (i) Establish effective competition between the manufacturers or their representatives or authorized agents in the European Union and importers of tobacco from nonmember countries;¹⁸⁷¹
- (ii) Ensure that the determination of the tax base of the proportional excise duty on tobacco products, i.e., the maxi-

¹⁸⁶⁴ Case C-197/04, *Commission v. Germany*.

¹⁸⁶⁵ Case C-638/15, *Eko-Tabak*.

¹⁸⁶⁶ See Case C-369/14, *Sommer Antriebs- und Funktechnik*, and the case-law cited there.

¹⁸⁶⁷ See, by analogy, Case C-319/96, *Brinkmann*, and Case C-197/04, *Commission v Germany*.

¹⁸⁶⁸ Case C-674/16, *Skonis ir kvapas*.

¹⁸⁶⁹ Tobacco Directive, Art. 6.

¹⁸⁷⁰ Tobacco Directive, Art. 15(1), first and second paras. Art. 15(1) does not preclude national legislation of a Member State that prohibits retailers from selling tobacco products at a unit price lower than the price indicated by the manufacturer or importer on the revenue stamp affixed to those products, insofar as that price has been freely determined by the manufacturer or importer (Case C-221/15, *Etablissements Fr. Colruyt*).

¹⁸⁷¹ Case C-216/98, *Commission v. Greece*.

imum retail selling price of those products, is subject to the same rules in all Member States;¹⁸⁷² and

(iii) Maintain the freedom of such economic operators to enable them to make genuine use of the competitive advantage resulting from any lower cost prices.

The imposition of a minimum retail selling price by the public authorities would thus mean that the maximum retail selling price determined by manufacturers and importers could not, in any event, be lower than that obligatory minimum price.

Legislation imposing such a minimum price is therefore capable of undermining competition by preventing some of those producers or importers from taking advantage of lower cost prices to offer more attractive retail selling prices.

Consequently, a system of minimum retail selling prices for tobacco products cannot be considered compatible with Article 15(1) of the Tobacco Directive, unless it is structured in such a way as to ensure, in any event, that the competitive advantage that could result for some producers and importers of such products from lower cost prices is not impaired and, thus, competition is not distorted.¹⁸⁷³

In addition, to facilitate the levying of excise duty, Member States may, for each group of manufactured tobacco, fix a scale of retail selling prices on condition that each scale has sufficient scope and variety to correspond in fact with the variety of products originating in the European Union, each scale being valid for all the products belonging to the group of manufactured tobacco that it concerns, without distinction based on:

- (i) The quality;
- (ii) The presentation
- (iii) The origin of the products or the materials used;
- (iv) The characteristics of the undertakings; or
- (v) Any other criterion.

The excise duty is, in principle, collected by means of tax stamps.¹⁸⁷⁴

Exemptions from excise duty may apply (or excise duty already paid may be refunded) with respect to:

- (i) Denatured manufactured tobacco used for industrial or horticultural purposes;
- (ii) Manufactured tobacco destroyed under administrative supervision;
- (iii) Manufactured tobacco solely intended for scientific tests and tests connected with product quality; and
- (iv) Manufactured tobacco reworked by the producer.¹⁸⁷⁵

e. Future Prospects

On October 19, 2020, the European Commission, in the annexes to its work programme for 2021, announced a revision of the Tobacco Directive.

The Commission noted that:

(i) The minima tax rates set by the Tobacco Directive had lost their effect as a large number of Member States taxed most tobacco products above the minima;

(ii) Several new types of tobacco products were not fully covered by the existing Directive;

(iii) The current situation resulted in the abuse of cross-border purchases.

The Commission undertook to consider a number of policy options based on the following building blocks:

(i) Minimum excise duty rates;

(ii) Harmonization of the taxation of new products (e-cigarettes, heated tobacco products and modern oral products); and

(iii) Fight against fraud.

A proposal for a revision of the Tobacco Directive was expected to be tabled on December 7, 2022, however, it has been delayed.¹⁸⁷⁶

2. Alcohol and Alcoholic Beverages

a. General

The relevant legislation with respect to excise duty on alcohol and alcoholic beverages is:

(i) Council Directive 92/83/EEC of October 19, 1992, on the harmonization of the structures of excise duties on alcohol and alcoholic beverages, as amended by Council Directive (EU) 2020/1151 (the “Alcohol Structure Directive”); and

(ii) Council Directive 92/84/EEC of October 19, 1992, on the approximation of the rates of excise duty on alcohol and alcoholic beverages (the “Alcohol Rate Directive.”)

b. Alcohol Structure Directive

The Alcohol Structure Directive sets out the common definitions for alcohol and alcoholic beverages and lays down the rules with regard to the establishment of the excise duty.¹⁸⁷⁷

Member States may apply reduced rates of excise duties to the different types of alcoholic beverages, subject to certain limits and conditions.

¹⁸⁷⁶ On November 30, 2022, the Commission officially postponed the proposal, reportedly due to public uproar in Sweden caused by the (unfounded) news that the proposal planned to tax snus, a popular oral tobacco product in Sweden but illegal elsewhere in the EU.

¹⁸⁷⁷ Member States need not require products covered by Council Directive 92/83/EEC of October 19, 1992 (“Alcohol Structure Directive”) to be manufactured in a tax warehouse from constituent alcoholic products held in suspension of the relevant excise duties, provided the duty on the constituents has already been paid in advance and the total tax payable on the constituent alcoholic products is not less than the tax payable on the product resulting from their mixture (Alcohol Structure Directive, Art. 24(1)).

¹⁸⁷² Case C-197/08, *Commission v. France*.

¹⁸⁷³ Case C-365/98, *Brinkmann*; Case C-216/98, *Commission v. Greece*; Case C-302/00, *Commission v. France*; Case C-197/08, *Commission v. France*; Case C-198/08, *Commission v. Austria*; Case C-221/08, *Commission v. Ireland*. The protection of public health cannot justify recourse to minimum prices (Case C-571/08, *Commission v. Italy*).

¹⁸⁷⁴ Tobacco Directive, Art. 16.

¹⁸⁷⁵ Tobacco Directive, Art. 17.

Excisable products include:

- (i) Beer;
- (ii) Still wine and sparkling wine;
- (iii) Fermented beverages other than wine and beer;
- (iv) Intermediate products; and
- (v) Ethyl alcohol,

all defined by reference to Combined Nomenclature (CN) codes in the version of the CN in force on October 19, 1992.¹⁸⁷⁸

(1) *Beer*

“Beer” covers:

- (i) Any product falling within CN code 2203; or
- (ii) Any product containing a mixture of beer with nonalcoholic drinks falling within CN code 2206,

with an actual alcoholic strength by volume exceeding 0.5% vol.¹⁸⁷⁹

The excise duty levied by Member States on beer is fixed by reference either to:

- (i) The number of hectoliter/degrees Plato (the “Plato approach;”) or
- (ii) The number of hectoliters/degrees of actual alcoholic strength by volume of finished product.¹⁸⁸⁰

All the ingredients of the beer, including those added after the completion of fermentation, must be taken into account for the purposes of measuring the degrees Plato. By way of derogation, Member States that, on July 29, 2020, did not take the ingredients of the beer that had been added after fermentation into account for the purposes of measuring the degrees Plato, may continue to do so until 31 December 2030.

In assessing the charge to duty on beer, Member States may ignore fractions of a degree Plato or degree of actual alcoholic strength by volume. In addition, Member States that levy the duty by reference to the number of hectoliters/degrees Plato may divide beer into categories consisting of no more than four degrees Plato per category and charge the same rate of duty per hectoliter on all beers falling within each category, such rates invariably equaling or exceeding the minimum rate laid down in the Alcohol Rate Directive.¹⁸⁸¹

A case brought before the CJEU illustrates that the Plato approach may be under pressure.¹⁸⁸² At issue is a Radler type of product containing considerably less alcohol than the beer it is based on. Therefore, one would expect a lower amount of excise duty to be due. However, because the product, besides beer, contains additional substances (including sugar and sweeteners), the Plato percentage of this beverage exceeds the Plato percentage of the beer it is based on. As a result, the excise duty on such products are likely to be higher than the excise duty on the beer they are made from. Despite the fact that the case concerns the question of whether the Plato percentage

of the beer (used as an ingredient) is to be applied, instead of the Plato percentage of the finished product, it not only demonstrates the level of complexity of the Plato approach but is also indicative of why many customs authorities have abandoned the Plato approach in favor of an alcohol-volume approach.

Member States may apply reduced rates of duty, which may be differentiated in accordance with the annual production of the breweries concerned, to beer brewed by independent small breweries within certain limits.

“Independent small brewery” means a brewery:

- (i) Legally and economically independent of any other brewery;
- (ii) Using premises situated physically apart from those of any other brewery; and
- (iii) Not operating under a license.

Where two or more small breweries cooperate and their combined annual production does not exceed 200,000 hectoliters, they may be treated as a single independent small brewery.¹⁸⁸³

A situation characterized by the existence of structural links in terms of shareholdings and voting rights that results in a situation in which one individual, performing his/her duties as a manager of a number of the breweries concerned, is able, independently of his/her actual conduct, to exercise influence over the taking of business decisions by those breweries, prevents them from being considered economically independent of each other.¹⁸⁸⁴

Member States may also apply reduced rates, which may fall below the minimum rate set under the Alcohol Rate Directive, for beer with an actual alcoholic strength by volume not exceeding 3.5% vol. Member States may confine the application of these reduced rates to products containing a mixture of beer with nonalcoholic drinks falling within CN code 2206.¹⁸⁸⁵

Member States may exempt from excise duty beer produced by a private individual and consumed by the producer, members of his/her family or his/her guests, provided no sale is involved.¹⁸⁸⁶

(2) *Still Wine and Sparkling Wine*

“Still wine” covers any product falling within CN codes 2204 and 2205, except sparkling wine as defined below, having an actual alcoholic strength by volume exceeding 1.2% but not exceeding 15%, if the alcohol contained in the finished product is entirely of fermented origin, or having an actual alcoholic strength by volume exceeding 15% and not exceeding 18% if the product has been produced without any enrichment and the alcohol contained in the finished product is entirely of fermented origin.¹⁸⁸⁷

“Sparkling wine” covers any product falling within CN codes 2204 10, 2204 21 06, 2204 21 07, 2204 21 08, 2204 21 09, 2204 29 10 and 2205 that is contained in a bottle with a “mushroom stopper” held in place by ties or fastenings, or has

¹⁸⁷⁸ Alcohol Structure Directive, Art. 26.

¹⁸⁷⁹ Alcohol Structure Directive, Art. 2.

¹⁸⁸⁰ Alcohol Structure Directive, Art. 3(1).

¹⁸⁸¹ Alcohol Structure Directive, Art. 3(2).

¹⁸⁸² C-30/17, *Kompania Piwowarska* (pending).

¹⁸⁸³ Alcohol Structure Directive, Art. 4.

¹⁸⁸⁴ Case C-83/08, *Gluckauf Brauerei*.

¹⁸⁸⁵ Alcohol Structure Directive, Art. 5.

¹⁸⁸⁶ Alcohol Structure Directive, Art. 6.

¹⁸⁸⁷ Alcohol Structure Directive, Art. 8(1).

an excess pressure due to carbon dioxide in solution of three bars or more, and has an actual alcoholic strength by volume exceeding 1.2% but not exceeding 15%, if the alcohol contained in the finished product is entirely of fermented origin.¹⁸⁸⁸

The excise duty levied by Member States on wine is fixed by reference to the number of hectoliters of finished product.¹⁸⁸⁹ Member States must levy the same rate of excise duty on all products chargeable with the duty on:

- (i) Still wine; and
- (ii) Sparkling wine.

However, they may apply:

- (i) The same rate of duty to both still and sparkling wine.¹⁸⁹⁰
- (ii) Reduced rates of excise duty to any type of still wine and sparkling wine of an actual alcoholic strength by volume not exceeding 8.5%.¹⁸⁹¹

Member States may apply reduced rates of duty to wine produced by independent small wine producers within the following limits:

- (i) The reduced rates may not be applied to undertakings producing on average more than 1 000 hl (or, in the case of the Republic of Malta, on average more than 20 000 hl of wine per year), and
- (ii) The reduced rates may not be set more than 50% below the standard national rate of excise duty.

An “independent small wine producer” is a wine producer:

- (i) Legally and economically independent of any other wine producer;
- (ii) Using premises situated physically apart from those of any other wine producer; and
- (iii) Not operating under a license.

Where two or more small wine producers cooperate, and their combined annual production does not exceed 1,000 hl or 20,000 hl, as appropriate, those wine producers may be treated as a single independent small wine producer.¹⁸⁹²

Member States may exempt from excise duty wine produced by a private individual and consumed by the producer, members of his/her family or his/her guests, provided no sale is involved.¹⁸⁹³

(3) *Fermented Beverages Other than Wine and Beer*

“Other still fermented beverages” covers:

- (i) Any product falling within CN codes 2204 and 2205 (other than still wine and sparkling wine within the meaning set out in XVIII.C.2.b.(2), above): and
- (ii) Any product falling within CN code 2206 (other than sparkling fermented beverages as defined below and any product covered by Article 2 (beer)) having an actual alco-

holic strength by volume exceeding 1.2% but not exceeding 10%, or having an actual alcoholic strength by volume exceeding 10% but not exceeding 15%, if the alcohol contained in the product is entirely of fermented origin.¹⁸⁹⁴

“Other sparkling fermented beverages” covers:

- (i) Any product falling within CN code 2206 00 31 and 2206 00 39; and

- (ii) Any product falling within CN codes 2204 10, 2204 21 06, 2204 21 07, 2204 21 08, 2204 21 09, 2204 29 10 and 2205 (other than still wine and sparkling wine within the meaning set out in XVIII.C.2.b.(2), above)

that is contained in a bottle with a “mushroom stopper” held in place by ties or fastenings or that has an excess pressure due to carbon dioxide in solution of three bars or more, and has an actual alcoholic strength by volume exceeding 1.2% but not exceeding 13%, or has an actual alcoholic strength by volume exceeding 13% but not exceeding 15%, if the alcohol contained in the product is entirely of fermented origin.¹⁸⁹⁵

The excise duty levied by Member States on other fermented beverages is fixed by reference to the number of hectoliters of finished product.¹⁸⁹⁶ Member States must levy the same rate of excise duty on all products chargeable with the duty on other still fermented beverages.

Similarly, they must levy the same rate of excise duty on all products chargeable with the duty on other sparkling fermented beverages.

However, subject to the exceptions set out in Articles 3(3) and 13a (see below), they may levy the same rate of excise duty on:

- (i) All products chargeable with the duty on other still fermented beverages;
- (ii) All products chargeable with the duty on other sparkling fermented beverages;
- (iii) Both other still fermented beverages and other sparkling fermented beverages.¹⁸⁹⁷

Member States may apply reduced rates of excise duty to any type of other still or sparkling fermented beverages of an actual alcoholic strength by volume not exceeding 8.5%.¹⁸⁹⁸

Article 13a allows Member States to apply reduced rates of duty, which may be differentiated in accordance with the annual production of the producers concerned, to other fermented beverages made by independent small producers within the following limits:

- (i) The reduced rates may not be applied to undertakings producing more than a total of 15,000 hl of such beverages per year; and
- (ii) The reduced rates may not be set more than 50% below the standard national rate of excise duty for other fermented beverages.

¹⁸⁸⁸ Alcohol Structure Directive, Art. 8(2).

¹⁸⁸⁹ Alcohol Structure Directive, Art. 9(1).

¹⁸⁹⁰ Alcohol Structure Directive, Art. 9(2).

¹⁸⁹¹ Alcohol Structure Directive, Art. 9(3).

¹⁸⁹² Alcohol Structure Directive, Art. 9a.

¹⁸⁹³ Alcohol Structure Directive, Art. 10.

¹⁸⁹⁴ Alcohol Structure Directive, Art. 12(1).

¹⁸⁹⁵ Alcohol Structure Directive, Art. 12(2).

¹⁸⁹⁶ Alcohol Structure Directive, Art. 13(1).

¹⁸⁹⁷ Alcohol Structure Directive, Art. 13(2).

¹⁸⁹⁸ Alcohol Structure Directive, Art. 13(3).

For these purposes, the other fermented beverages must be obtained from the fermentation of fruits, berries, vegetables, a solution of honey in water or from the fermentation of fresh juice or concentrated juice obtained from the foregoing.

In this respect, the addition of alcohol to dilute or dissolve flavorings is not regarded as the addition of alcohol for the purpose of production of other fermented beverages to the extent:

- (i) the amount added is strictly necessary for that purpose;
- (ii) the alcoholic strength does not increase by more than 1.2 % vol.; and
- (iii) the addition of such flavorings does not significantly alter the character of the original product.

Member States may limit the application of this provision to certain types of other fermented beverages.

An “independent small producer” means a producer of other fermented beverages:

- (i) Legally and economically independent of any other producer of other fermented beverages;
- (ii) Using premises situated physically apart from those of any other producers; and
- (iii) Not operating under a license.

Where two or more small producers cooperate, and their combined annual production does not exceed 15,000 hl, those producers may be treated as a single independent small producer.

Member States may exempt from excise duty other still and sparkling fermented beverages produced by a private individual and consumed by the producer, members of his/her family or his/her guests, provided no sale is involved.¹⁸⁹⁹

(4) *Intermediate Products*

“Intermediate products” covers any product of an actual alcoholic strength by volume exceeding 1.2%, but not exceeding 22% and falling within CN codes 2204, 2205 and 2206 (but not covered by Articles 2 (beer), 8 (still wine and sparkling wine), and 12 (fermented beverages other than wine and beer)).¹⁹⁰⁰

In addition, Member States may treat as an intermediate product:

- (i) Any still fermented beverage falling within the scope of Article 12(1) (“other still fermented beverages”) that has an actual alcoholic strength by volume exceeding 5.5% and that is not entirely of fermented origin; and
- (ii) Any sparkling fermented beverage falling within the scope of Article 12(2) (“other sparkling fermented beverages”) that has an actual alcoholic strength by volume exceeding 8.5% and that is not entirely of fermented origin.¹⁹⁰¹

The excise duty levied by Member States on intermediate products is fixed by reference to the number of hectoliters of finished product.¹⁹⁰² Member States must charge the same rate

of duty on all products chargeable with the duty on intermediate products.¹⁹⁰³ In addition, a Member State may apply a single reduced rate of duty to certain intermediate products.¹⁹⁰⁴

Member States may apply reduced rates of duty, which may be differentiated in accordance with the annual production of the producers concerned, to intermediate products made by independent small producers within the following limits:

(i) The reduced rates may not be applied to undertakings producing more than a total of 250 hl of such beverages per year; and

(ii) The reduced rates, which may fall below the minimum rate, may not be set more than 50% below the standard national rate of intermediate products.

Member States may limit the application of this provision to certain types of intermediate products.

An “independent small producer” is a producer of intermediate products:

(i) Legally and economically independent of any other producer of intermediate products;

(ii) Using premises situated physically apart from those of any other producers; and

(iii) Not operating under a license.

Where two or more small producers cooperate, and their combined annual production does not exceed 250 hl, those producers may be treated as a single independent small producer.¹⁹⁰⁵

For intermediate products contained in bottles with “mushroom stoppers” held in place by ties or fastenings, or that have an excess pressure due to carbon dioxide in solution of three bars or more, Member States may apply the same rate as provided for products falling within the scope of Article 12(2) (“other sparkling fermented beverages,”) provided this rate is higher than the national rate for intermediate products.¹⁹⁰⁶

(5) *Ethyl Alcohol*

“Ethyl alcohol” covers:

(i) Any product with an actual alcoholic strength by volume exceeding 12% that falls within CN codes 2207 and 2208, even when the product forms part of a product that falls within another chapter of the CN;

(ii) Any product within CN codes 2204, 2205 and 2206 that has an actual alcoholic strength by volume exceeding 22%; and

(iii) Potable spirits containing such products, whether in solution or not.¹⁹⁰⁷

¹⁹⁰³ Alcohol Structure Directive, Art. 18(2).

¹⁹⁰⁴ Alcohol Structure Directive, Art. 18(3) and (4).

¹⁹⁰⁵ Alcohol Structure Directive, Art. 18a.

¹⁹⁰⁶ Alcohol Structure Directive, Art. 18(5).

¹⁹⁰⁷ Alcohol Structure Directive, Art. 20. Cooking wine and cooking port, which, as edible preparations, fall within chapter 21 of the CN contain ethyl alcohol falling within heading 2208 of that nomenclature; since that alcohol has an alcoholic strength by volume exceeding 1.2%, it falls within the scope of the Alcohol Structure Directive, Art. 20, first indent (Case C-163/09, *Repertoire Culinaire*; C-458/06, *Gourmet Classic*). According to the CJEU, bioethanol used as fuel, which is ethyl alcohol of an alcoholic strength by volume of over

¹⁸⁹⁹ Alcohol Structure Directive, Art. 14.

¹⁹⁰⁰ Alcohol Structure Directive, Art. 17(1).

¹⁹⁰¹ Alcohol Structure Directive, Art. 17(2).

¹⁹⁰² Alcohol Structure Directive, Art. 18(1).

The excise duty on ethyl alcohol is fixed per hectoliter of pure alcohol at 20°C and is calculated by reference to the number of hectoliters of pure alcohol. Member States must charge the same rate of duty on all products chargeable with the duty on ethyl alcohol.¹⁹⁰⁸

Member States may apply reduced rates of excise duty to ethyl alcohol produced by small distilleries within certain limits.

A “small distillery” is a distillery:

- (i) Legally and economically independent of any other distillery; and
- (ii) Not operating under a license.¹⁹⁰⁹

In addition, Member States may apply reduced rates of duty to products falling within CN code 2208 that have an actual alcohol strength by volume not exceeding 10%.¹⁹¹⁰

Subject to laying down conditions, requirements and procedures to prevent evasion, avoidance or abuse or cross-border effects and sale, Member States are allowed to exempt from excise duty, or to apply reduced rates of excise to ethyl alcohol that is consumed by a private individual, the members of his family or his guests, provided that no sale is involved, and which is:

- (i) Produced by that private individual from fruits owned, grown and supplied by that private individual from a plot of land to which that private individual holds a title, using simple, small distilling device registered with the competent authority of the Member State concerned; and/or
- (ii) Produced for that private individual in distilleries authorized by the competent authority of the Member State concerned, from fruits owned, grown and supplied by that private individual from a plot of land to which that private individual holds a title.

Member States are to limit the application of this exemption or of the relevant reduced rates to not more than 50 liters of fruit spirits per producing fruit grower’s household per year.¹⁹¹¹

(6) *Refund of Excise Duty; Exemptions*

(a) *Refund of Excise Duty*

Member States may refund the excise duty on alcoholic drinks withdrawn from the market because their condition or age renders them unfit for human consumption.¹⁹¹²

(b) *Exemptions*

Aside from the (product-specific) exemptions discussed above, Article 27(1) of the Alcohol Structure Directive provides certain exemptions from the harmonized excise duty that

the Member States must apply subject to conditions laid down for the purposes of:

- (i) Ensuring the correct and straightforward application of such exemptions; and
- (ii) Preventing any evasion, avoidance or abuse.

The objective of these exemptions is to neutralize the impact of excise duties on alcohol used as an intermediate product in other commercial or industrial products.¹⁹¹³

The exemption of products covered by Article 27(1) is the rule, and refusal is the exception. As such, the power granted to Member States by that provision to lay down conditions for the purposes of “ensuring the correct and straightforward application of such exemptions and of preventing any evasion, avoidance or abuse” cannot detract from the unconditional nature of the obligation imposed by that provision to grant exemption. Consequently, in exercising that power, the Member State concerned must put forward concrete, objective and verifiable evidence of a serious risk of evasion, avoidance or abuse. The conditions laid down by the Member State by virtue of the power thus conferred on it cannot go beyond what is necessary to attain that objective.¹⁹¹⁴

If products that have been treated as:

- (i) Not subject to excise duty; or
- (ii) Exempted from that duty under the Alcohol Structure Directive and released for consumption in the Member State of manufacture,

are intended to be put on the market in another Member State, the latter Member State must treat those products in the same way in its territory, unless there is concrete, objective and verifiable evidence that:

- (a) The first Member State has failed to apply the provisions of the Directive correctly; or
- (b) It is justifiable to adopt measures to combat any evasion, avoidance or abuse that may arise in the field of exemptions and to ensure the correct and straightforward application of such exemptions.¹⁹¹⁵

Specifically, the exemptions under Article 27(1) concern the products covered by the Alcohol Structure Directive when they are:

- (i) Distributed in the form of alcohol which has been completely denatured in accordance with duly notified and authorized requirements of the Member State where it has been released for consumption;
- (ii) Used as part of the manufacturing process of any product not for human consumption, provided the alcohol has been denatured in accordance with the requirements of any Member State for the given use (the exemption presupposes that the relevant denatured alcohol has been incorporated into the product not for human consumption or is used for maintenance and cleaning of the manufacturing equipment used for this particular manufacturing process);

80%, must be considered to fall within CN code 2207 despite the fact that the term “bioethanol” is not found in the wording of that CN heading. Falling within CN code 2207 and with an actual alcoholic strength by volume exceeding 1.2%, it therefore meets the definition of ethyl alcohol in Directive 92/83, Art. 20, first indent (Case C-503/10, *Evroetil*).

¹⁹⁰⁸ Alcohol Structure Directive, Art. 21.

¹⁹⁰⁹ Alcohol Structure Directive, Art. 22(1) and (2).

¹⁹¹⁰ Alcohol Structure Directive, Art. 22(5).

¹⁹¹¹ Alcohol Structure Directive, Art. 22(8).

¹⁹¹² Alcohol Structure Directive, Art. 25.

¹⁹¹³ Case C-482/98, *Italy v. Commission* and Case C-63/06, *Profisa*.

¹⁹¹⁴ Case C-163/09, *Repertoire Culinaire*; Case C-482/98, *Italy v. Commission*, para. 4, and Case C-63/06, *Profisa*.

¹⁹¹⁵ Case C-163/09, *Repertoire Culinaire*.

- (iii) Used for the production of vinegar falling within CN code 2209;
- (iv) Used for the production of medicines defined by Directives 2001/82/EC and 2001/83/EC;
- (v) Used for the production of flavors for the preparation of foodstuffs and nonalcoholic beverages with an alcohol strength by volume not exceeding 1.2%; or
- (vi) Used directly or as a constituent of semi-finished products for the production of foodstuffs, filled or otherwise, provided, in each case, the alcoholic content does not exceed 8.5 liters of pure alcohol per 100 kg of the product in the case of chocolates, and 5 liters of pure alcohol per 100 kg of the product in the case of other products.

As regards the delineation between the exemptions provided in Article 27(1)(a) and (b), the CJEU has made it clear that the granting or refusal of an exemption is dependent on the denaturing method:

- (i) If that method has been approved at EU level, the alcohol is exempted from excise duty under Article 27(1)(a).
- (ii) If the alcohol contained in a product not intended for human consumption has been denatured in accordance with a method approved in a Member State, the exemption provided for by Article 27(1)(b) should be applied.
- (iii) If the denaturing method is not one of those approved under either EU rules or national law, the product cannot be exempted.¹⁹¹⁶

As regards the delineation between the exemptions provided in Article 27(1)(e) and (f), the CJEU has held that, although it cannot be ruled out that cooking wine, cooking port and cooking cognac may be used for the production of flavors for the preparation of foodstuffs and nonalcoholic beverages within the meaning of Article 27(1)(e), where they are used for the production of culinary dishes, as ingredients incorporated therein, any exemption from excise duty will, as a rule, be under Article 27(1)(f).¹⁹¹⁷

Under Article 27(1)(f), Member States are to exempt from harmonized excise duty ethyl alcohol imported into the customs territory of the European Union contained in chocolate products intended for direct use, where the alcohol content does not exceed 8.5 liters for every 100 kilograms of the chocolate products.¹⁹¹⁸

In addition, under Article 27(2), Member States may exempt products covered by the Alcohol Structure Directive from the harmonized excise duty subject to conditions that they lay down for the purposes of ensuring the correct and straightforward application of such exemptions and preventing any evasion, avoidance or abuse, when such products are used:

- (i) As samples for analysis, necessary production tests or scientific purposes;
- (ii) For scientific research;
- (iii) For medical purposes in hospitals and pharmacies;

- (iv) In a manufacturing process, provided the final product does not contain alcohol;
- (v) In the manufacture of a component product that is not subject to excise duty under the Alcohol Structure Directive; or
- (vi) In the manufacture of food supplements defined by Directive 2002/46/EC containing ethyl alcohol, if the unit packet of the food supplement released for consumption does not exceed 0.15 liters and food supplements are placed on the market pursuant to Article 10 of that Directive.

For the purposes of the exemptions set out in Article 27, Member States are free to give effect to such exemptions by means of a refund of excise duty paid.¹⁹¹⁹

c. Alcohol Rate Directive

The Alcohol Rate Directive complements the Alcohol Structure Directive (and the Horizontal Directive) by providing the minimum rates of excise duty on alcohol and alcoholic beverages that Member States are to apply.¹⁹²⁰

The products covered by this Directive are;

- (i) Alcohol and alcoholic beverages;
- (ii) Intermediate products;
- (iii) Wine; and
- (iv) Beer,

as defined in the Alcohol Structure Directive.

The minimum rate of excise duty on alcohol and alcohol contained in beverages (other than intermediate products, wine and beer) is fixed at 550 euros¹⁹²¹ per hectoliter of pure alcohol.¹⁹²²

The minimum rate of excise duty on intermediate products is fixed at 45 euros per hectoliter of product.¹⁹²³

The minimum rate of excise duty on both still wine and sparkling wine is fixed at 0 euros per hectoliter of product.¹⁹²⁴

The minimum rate of excise duty on beer is fixed at 0.748 euros per hectoliter/degree Plato, or 1.87 euros per hectoliter/degree of alcohol of finished product.¹⁹²⁵

In *Socridis*,¹⁹²⁶ it was argued that the Alcohol Rate Directive was incompatible with the second paragraph of Article 110 of the TFEU (prohibition on protective internal taxation)¹⁹²⁷ because fixing the minimum rate of excise duty on wine at zero amounted to authorizing the Member States to exonerate wine permanently from all excise duty, such an exoneration favoring what was an essential product for the States in the south of Eu-

¹⁹¹⁹ Alcohol Structure Directive, Art. 27(6).

¹⁹²⁰ Special rules apply for Greece and for the regions of Gorizia and the Aosta valley, and the autonomous regions of Madeira and the Azores (Council Directive 92/84/EEC of October 19, 1992 ("Alcohol Rate Directive"), Art. 7).

¹⁹²¹ The Directive states amounts in ECU, but ECU1 = 1 euro.

¹⁹²² Alcohol Rate Directive, Art. 3.

¹⁹²³ Alcohol Rate Directive, Art. 4.

¹⁹²⁴ Alcohol Rate Directive, Art. 5.

¹⁹²⁵ Alcohol Rate Directive, Art. 6.

¹⁹²⁶ Case C-166/98, *Socridis*.

¹⁹²⁷ See XIX.C., below.

¹⁹¹⁶ Case C-482/98, *Italy v. Commission*.

¹⁹¹⁷ Case C-163/09, *Repertoire Culinaire*; Case C-458/06, *Gourmet Classic*.

¹⁹¹⁸ Case C-63/06, *Profisa*.

rope, where beer represented neither a sector nor a beverage of cultural importance.

The CJEU reiterated its settled case law, according to which only commonly consumed wines, which in general are cheap wines, have enough characteristics in common with beer to constitute an alternative choice for consumers and may therefore be regarded as being in competition with beer for the purposes of the second paragraph of Article 110.

Consequently, the ground of invalidity based on that provision for challenging the minimum excise duty fixed by the Alcohol Rate Directive arose only to the extent it applied to commonly consumed wines.

However, the Court also held that it was also settled case law that directives did not infringe the Treaty if they left Member States a sufficiently wide margin of appreciation to enable them to transpose them into national law in a manner consistent with the requirements of the Treaty. As the Alcohol Rate Directive, in conjunction with the Alcohol Structure Directive, merely required Member States to apply a minimum excise duty on beer, the Member States retained a sufficiently wide margin of discretion to ensure that the relationship between the taxes on wine and beer excluded any protection for domestic production within the meaning of Article 110 and, hence, the plea that those Directives were invalid because they were incompatible with the second paragraph of Article 110 was rejected.

Every two years, the Council, acting on a report and, where appropriate, a proposal from the Commission, must examine the rates of duty laid down in the Alcohol Rate Directive and, acting unanimously and having consulted with the European Parliament, must adopt the necessary measures.

The Commission report and the consideration by the Council must take into account;

- (i) The proper functioning of the internal market;
- (ii) Competition between the different categories of alcoholic drinks;
- (iii) The real value of the rates of duty; and
- (iv) The wider objectives of the Treaty.¹⁹²⁸

3. Energy Products and Electricity

a. General

The legislative instrument with respect to excise duty on energy products and electricity is Council Directive 2003/96/EC of October 27, 2003 restructuring the Community framework for the taxation of energy products and electricity (which repealed Council Directives 92/81/EEC and 92/82/EEC and replaced the excise duty on mineral oils with the taxation of en-

ergy products including coal, natural gas and electricity)¹⁹²⁹ (the “Energy Tax Directive.”)

The Energy Tax Directive defines the tax structures and the minimum rates of excise duty that Member States must apply to energy products and electricity.¹⁹³⁰

b. Scope of Application

The term “energy products” is defined by reference to the codes of the CN¹⁹³¹ and, as such, covers products falling within:

- (i) CN codes 1507 to 1518, if they are intended for use as heating fuel or motor fuel;
- (ii) CN codes 2701, 2702 and 2704 to 2715;
- (iii) CN codes 2901 and 2902;
- (iv) CN code 2905 11 00 that are not of synthetic origin, if they are intended for use as heating fuel or motor fuel;
- (v) CN code 3403;
- (vi) CN code 3811;
- (vii) CN code 3817; and
- (viii) CN code 3824 90 99, if they are intended for use as heating fuel or motor fuel.¹⁹³²

The Energy Tax Directive also applies to electricity falling within CN code 2716.¹⁹³³

As regards “mineral oils” — a term now construed under the Energy Tax Directive as referring to all energy products and electricity covered by the Directive¹⁹³⁴ — CJEU case law has been struggling with the distinction between motor oil and heating oil.

When intended for use, offered for sale or used as motor fuel or heating fuel, energy products other than those for which a level of taxation is specified in the Energy Tax Directive are

¹⁹²⁹For the period ending December 31, 2003, the Member States were obliged, under Directive 92/81, Art. 1(1), to impose a harmonized excise duty on “mineral oils” within the meaning of the Directive. From January 1, 2004, the Member States are required, under Council Directive 2003/96/EC of October 27, 2003 (Energy Tax Directive), Art. 1, which repealed Directive 92/81, to tax “energy products” within the meaning of the Energy Tax Directive, which, as stated in recitals 2 and 3 of its preamble, is intended to impose minimum levels of taxation at EU level for most of those energy products rather than for mineral oils alone (Joined Cases C-145/06 and C-146/06, *Fendt Italiana*).

¹⁹³⁰Other legislation covering the taxation of energy products includes Council Directive 95/60/EC on fiscal marking of gas oils and kerosene. This Directive provides a common marking system for identifying gas oil and kerosene subject to a reduced excise rate, e.g., mineral oil used as a propellant. The aim of this marking is to prevent tax evasion and ensure the proper functioning of the internal market. The rules are without prejudice to national provisions on fiscal marking. Commission Decision 2011/544/EC establishes Solvent Yellow 124 as the common fiscal marker and fixes the marking level of at least 6 mg and not more than 9 mg of marker per liter of mineral oil.

¹⁹³¹References are to the codes of the CN of Commission Regulation (EC) No 2031/2001 of August 6, 2001, amending Annex I to Council Regulation (EEC) No 2658/87 on the tariff and statistical nomenclature and on the Common Customs Tariff. A Decision to update the codes of the CN for the products referred to in the Energy Tax Directive must be made once every year in accordance with the procedure laid down in Art. 27. The Decision must not result in any changes in the minimum tax rates applied in the Directive or the addition or removal of any energy products and electricity (Energy Tax Directive, Art. 2(5)).

¹⁹³²Energy Tax Directive, Art. 2(1).

¹⁹³³Energy Tax Directive, Art. 2(2).

¹⁹³⁴Energy Tax Directive, Art. 3.

¹⁹²⁸Alcohol Rate Directive, Art. 8.

to be taxed according to use, at the rate for the equivalent heating fuel or motor fuel. The same holds true for any product intended for use, offered for sale or used as motor fuel, or as an additive or extender in motor fuels, which is to be taxed at the rate for the equivalent motor fuel, and for any other hydrocarbon, except for peat, intended for use, offered for sale or used for heating purposes, which is to be taxed at the rate for the equivalent energy product.¹⁹³⁵

The Energy Tax Directive does not apply to:

(i) The output taxation of heat or the taxation of products falling within CN codes 4401 and 4402;¹⁹³⁶ or

(ii)¹⁹³⁷ Energy products used for the purposes other than motor fuel or heating fuel; the dual use¹⁹³⁸ (i.e., use both as heating fuel and for¹⁹³⁹ purposes other than motor fuel and heating fuel) of energy products; electricity used principally for the¹⁹⁴⁰ purposes of chemical reduction and in electrolytic and metallurgical processes; electricity, when it accounts for more than 50% of the cost of a product; and mineralogical processes.

c. Minimum Levels of Taxation

The levels of taxation that Member States must apply to the energy products and electricity subject to excise duty may not be less than the minimum levels of taxation prescribed by the Energy Tax Directive.

For these purposes, “level of taxation” means the total charge levied in the form of all indirect taxes (except VAT) calculated directly or indirectly on the quantity of energy products and electricity at the time of release for consumption.¹⁹⁴¹

The minimum levels are set out in;

- (i) Table A (motor fuels);
- (ii) Table B (products used as motor fuel); and
- (iii) Table C (heating fuel and electricity)

¹⁹³⁵ Energy Tax Directive, Art. 2(3).

¹⁹³⁶ Energy Tax Directive, Art. 2(4)(a).

¹⁹³⁷ Energy Tax Directive, Art. 2(4)(b).

¹⁹³⁸ A Member State is entitled to apply, in its national law, a more restrictive scope to the concept of “dual use” than that which it has under the Energy Tax Directive, with a view to levying a tax on energy products excluded from the scope of that Directive (Case C-426/12, X).

¹⁹³⁹ E.g., the use of energy products for chemical reduction and in electrolytic and metallurgical processes is regarded as dual use. By contrast, natural gas used, first, for superheating and drying steam that is then used in the ammonia production process and, secondly, for the thermal decomposition and drawing off of residual gases created by that process, does not constitute an energy product that has a dual use (Case C-529/14, *YARA Brunsbüttel*). Also, the fact of using, first, coal as a heating fuel in the sugar production process and, second, carbon dioxide generated by the combustion of that energy product to produce chemical fertilizers does not constitute “dual use” of that energy product; however, the fact of using, first, coal as a heating fuel in the sugar production process and, secondly, carbon dioxide generated by the combustion of that energy product for purposes of the same production process does constitute “dual use” if it is established that the sugar production process cannot be completed without using the carbon dioxide generated by the combustion of the coal (Case C-426/12, X).

¹⁹⁴⁰ “Cost of a product” means the aggregate of total purchases of goods and services, personnel costs and the consumption of fixed capital, at the level of the business, as defined in Art. 11. This cost is calculated per unit on average. “Cost of electricity” means the actual purchase value of electricity, or the cost of production of electricity if the electricity is generated in the business.

¹⁹⁴¹ Energy Tax Directive, Art. 4.

of Annex I to the Energy Tax Directive (which Tables refer to Articles 7, 8, 9 and 10 of the Energy Tax Directive, respectively).

Provided they respect the minimum levels of taxation prescribed by the Energy Tax Directive and they are compatible with EU law, differentiated rates of taxation may be applied by Member States, under fiscal control:

(i) When the differentiated rates are directly linked to product quality;

(ii) When the differentiated rates depend on quantitative consumption levels for electricity and energy products used for heating purposes;

(iii) For the following uses:

- Local public passenger transport (including taxis);
- Waste collection;
- The armed forces;
- Public administration;
- The disabled;
- Ambulances; and

(iv) Between business and nonbusiness use, in the case of energy products and electricity referred to in Articles 9 and 10 (i.e., heating fuels and electricity).¹⁹⁴²

Member States are free to give effect to the exemptions or reductions in the level of taxation prescribed by the Energy Tax Directive either directly, by means of a differentiated rate, or by refunding all or part of the amount of tax levied.¹⁹⁴³

d. Exemptions and Tax Reductions

Besides the general provisions set out in the Horizontal Directive on exempt uses of taxable products, and without prejudice to other provisions of EU law, Member States must exempt the following from taxation subject to conditions that they lay down for the purposes of ensuring the correct and straightforward application of such exemptions and preventing any evasion, avoidance or abuse:¹⁹⁴⁴

(i) Energy products and electricity used to produce electricity and electricity used to maintain the ability to produce electricity (Member States may, for reasons of environmental policy, subject these products to taxation without having to respect the minimum levels of taxation laid down in the Directive);¹⁹⁴⁵

¹⁹⁴² Energy Tax Directive, Art. 5.

¹⁹⁴³ Energy Tax Directive, Art. 6; see Case C-63/19, *Commission v. Italy*.

¹⁹⁴⁴ Energy Tax Directive, Art. 14(1). As regards the exemptions referred to in Art. 14(1)(b) and (c), Member States may limit their scope to international and intra-Community transportation or waive such exemptions under a bilateral agreement with another Member State (Energy Tax Directive, Art. 14(2)).

¹⁹⁴⁵ The compulsory exemption applies to energy products used for electricity generation, when such products are used for the combined generation of electricity and heat within the meaning of Energy Tax Directive, Art. 15(1) (c) (see (iii) of next paragraph). See Case C-250/10, *Haltergemeinschaft LBL GbR* and Case C-31/17, *Cristal Union*. See also Case C-571/21, *RWE Power*, in which the CJEU held that the tax exemption does not cover electricity used in connection with the extraction of an energy product, such as lignite, from an opencast mine, where the electricity is used not in the technological process of electricity production, but for the manufacture of an energy product. Nonetheless,

(ii) Energy products supplied for use as fuel for the purposes of air navigation other than in private pleasure-flying (Member States may limit the scope of this exemption to supplies of jet fuel (CN code 2710 19 21)); and

(iii) Energy products supplied for use as fuel for the purposes of navigation within EU waters (including fishing), other than in private pleasure craft, and electricity produced on board a vessel.

Moreover, without prejudice to other EU provisions, Member States may apply, under fiscal control, total or partial exemptions or reductions in the level of taxation to:¹⁹⁴⁶

(i) Taxable products used under fiscal control in the field of pilot projects for the technological development of more environmentally friendly products or in relation to fuels from renewable resources;

(ii) Electricity of solar, wind, wave, tidal or geothermal origin; electricity of hydraulic origin produced in hydro-electric installations; electricity generated from biomass or from products produced from biomass; electricity generated from methane emitted by abandoned coal mines; and electricity generated from fuel cells (Member States may also refund to the producer some or all of the amount of tax paid by the consumer on electricity produced from these products);

(iii) Energy products and electricity used for combined heat and power generation;

(iv) Electricity produced from combined heat and power generation, provided the combined generators are environmentally friendly (Member States may apply national definitions of “environmentally friendly” (or high efficiency) cogeneration production until the Council, based on a report and a proposal from the Commission, unanimously adopts a common definition);

(v) Energy products and electricity used for the carriage of goods and passengers by rail, metro, tram or trolley bus;

(vi) Energy products supplied for use as fuel for navigation on inland waterways (including fishing) other than in private pleasure craft, and electricity produced on board a vessel;

(vii) Natural gas, in Member States in which the share of natural gas in final energy consumption was less than 15% in 2000;

(viii) Electricity, natural gas, coal and solid fuels used by households and/or by organizations recognized as charitable by the Member State concerned (in the case of chari-

table organizations, a Member State may confine the exemption or reduction to use for purposes of nonbusiness activities or, where mixed use takes place, to apply taxation in proportion to each type of use — if a type of use is insignificant, it may be treated as nil);

(ix) Natural gas and LPG used as propellants;

(x) Motor fuels used in the field of the manufacture, development, testing and maintenance of aircraft and ships;

(xi) Motor fuels used for dredging operations in navigable waterways and in ports; and

(xii) Products falling within CN code 2705 used for heating purposes.

Member States may apply a level of taxation as low as zero to energy products and electricity used for agricultural, horticultural or aquacultural works, or in forestry.¹⁹⁴⁷

Member States may also, within certain limits, apply an exemption or a reduced rate of taxation under fiscal control to the taxable products referred to in Article 2, where such products are made up of, or contain, one or more of certain specified components (for example, products or components produced from biomass and products containing water).¹⁹⁴⁸

Finally, provided the minimum levels of taxation prescribed in the Energy Tax Directive are respected on average for each business, Member States may apply tax reductions to the consumption of energy products used for heating purposes or for the purposes of Article 8(2)(b) and (c), and to electricity in the following cases:

(i) In favor of an energy-intensive business (i.e., a business entity where either the purchases of energy products and electricity amount to at least 3% of the production value or the national energy tax payable amounts to at least 0.5% of the added value, it being understood that, within this definition, Member States may apply more restrictive criteria, including sales value, process and sector definitions; the level of taxation may be as low as zero); and

(ii) Where agreements are concluded with undertakings or associations of undertakings, or where tradable permit schemes or equivalent arrangements are implemented, to the extent they lead to the achievement of environmental protection objectives or to improvements in energy efficiency.¹⁹⁴⁹

Transitional arrangements for specific Member States (or regions, departments or authorities of Member States) are set out in Article 18 of the Energy Tax Directive, but these have (mostly) since become obsolete.

In addition to the exemptions and reductions set out above, the Council, acting unanimously on a proposal from the Commission, may authorize any Member State to introduce further exemptions or reductions based on specific policy considerations.¹⁹⁵⁰ These authorizations are granted for a maximum peri-

less, the exemption may cover the subsequent conversion and processing of that energy product in power stations to produce electricity, provided those operations are essential and contribute directly to the technological process of the production. The tax exemption may also cover electricity intended for the operation of storage facilities for an energy product, such as lignite, and of means of transport allowing that product to be transported where those operations take place inside power stations, provided they are essential and contribute directly to maintaining capacity for the technological process of electricity production, inasmuch as such operations are required to guarantee the maintenance of capacity to ensure uninterrupted electricity production.

¹⁹⁴⁶ Energy Tax Directive, Art. 15(1).

¹⁹⁴⁷ Energy Tax Directive, Art. 15(2). It is intended that, over time, the ability to apply a level of taxation as low as zero will be repealed.

¹⁹⁴⁸ Energy Tax Directive, Art. 16(1).

¹⁹⁴⁹ Energy Tax Directive, Art. 17(1).

¹⁹⁵⁰ Energy Tax Directive, Art. 19(1).

od of six years, with the possibility of renewal.¹⁹⁵¹ If the Commission considers that the exemptions or reductions are no longer sustainable, particularly in terms of fair competition or distortion of the operation of the internal market, or in terms of EU policy in the areas of health, protection of the environment, energy and transport, it is to submit appropriate proposals to the Council and the Council is to make a unanimous decision on these proposals.¹⁹⁵²

Member States may refund the amount of tax already paid on contaminated or accidentally mixed energy products sent back to a tax warehouse for recycling.¹⁹⁵³

It is expressly emphasized that measures such as:

- (i) Tax exemptions;
- (ii) Tax reductions;
- (iii) Tax differentiation; and
- (iv) Tax refunds

within the meaning of the Energy Tax Directive may constitute State aid and, if this is the case, notice of such measures must be given to the Commission pursuant to Article 108(3) of the TFEU. Information provided to the Commission based on the Energy Tax Directive does not free Member States from the notification obligation under Article 108(3).¹⁹⁵⁴

e. Future Prospects

Further to Article 29 of the Energy Tax Directive, the Council, acting on a report and, where appropriate, a proposal from the Commission, periodically examines the exemptions, reductions and minimum levels of taxation laid down in the Directive and, acting unanimously after consulting the European Parliament, adopts the necessary measures.

The Commission report and the consideration by the Council must take into account:

- (i) The proper functioning of the internal market;
- (ii) The real value of the minimum levels of taxation; and
- (iii) The wider objectives of the Treaty.

On April 13, 2011, the Commission presented a proposal for overhauling what it felt was the outdated rules on the taxation of energy products in the European Union (the “2011 Proposal.”)¹⁹⁵⁵

However, following the unsuccessful negotiations between the Member States in the Council, the Commission eventually withdrew the 2011 Proposal in 2015.

On March 4, 2020, the Commission commenced a consultation process for the revision of the Energy Taxation Directive by publishing an Inception Impact Assessment (“IIA”) as part of the European Green Deal announced in December 2019 and the EU’s efforts to be carbon neutral by 2050.¹⁹⁵⁶

The revision aimed to:

- (i) Align the taxation of energy products and electricity with EU energy and climate policies; and
- (ii) Preserve the EU single market by updating the scope and the structure of tax rates and rationalizing the use of tax exemptions and reductions.

The IIA reflected the Commission’s belief that a revision of the Energy Taxation Directive was required in the light of the developments since its adoption in 2003.

These developments include:

- (i) The emergence of renewable energy markets and technologies;
- (ii) The EU’s international commitments (e.g., the December 12, 2015 Paris Agreement);
- (iii) The enhancement of the EU’s regulatory framework in the field of energy and climate change. Specifically, it was felt that the Energy Taxation Directive did not adequately promote Greenhouse Gas (GHG) emission reductions, energy efficiency or alternative fuels (e.g., hydrogen, synthetic fuels and advanced biofuels) or provide sufficient incentives for investments in clean technologies.

The IIA indicated that the revision of the Energy Taxation Directive aimed to tackle three issues:

- (i) The ongoing use of fossil fuel subsidies in EU Member States;
- (ii) The lack of alignment between the Energy Taxation Directive and other EU policies such as the EU Emissions Trading Scheme (“ETS,”) the Renewable Energy Directive and the Energy Efficiency Directive; and
- (iii) The lack of relevance of the current Energy Taxation Directive for the internal market since the minimum tax rates had lost their effect.

To address these issues, the IIA listed a number of policy options, such as:

- (i) Minimum excise rates, taking into account energy content and linkages to greenhouse gas emissions;
- (ii) Sectoral tax differentiation, taking into account existing differentiation between motor and heating fuel and focusing on tackling fossil fuel subsidies; and
- (iii) Product coverage, taking into account that the use of certain new energy products (such as hydrogen, synthetic fuels, e-fuels, advanced biofuels, and electricity) was currently discouraged since they could be taxed in the same manner as traditional energy products.

The intention was thus to ensure, among other things, that “green” renewable electricity could be taxed more favorably

¹⁹⁵¹ Energy Tax Directive, Art. 19(2).

¹⁹⁵² Energy Tax Directive, Art. 19(3).

¹⁹⁵³ Energy Tax Directive, Art. 23.

¹⁹⁵⁴ Energy Tax Directive, Art. 26(1) and (2).

¹⁹⁵⁵ Proposal for a Council Directive amending Directive 2003/96/EC restructuring the Community framework for the taxation of energy products and electricity, COM (2011) 169.

¹⁹⁵⁶ Communication from the Commission of December 11, 2019 to the European Parliament, the European Council, the Council, the European Eco-

nomic and Social Committee and the Committee of the Regions — The European Green Deal, COM (2019) 640 final, see: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM%3A2019%3A640%3AFIN>. For an (illustrative) overview of the constituent elements of the European Green Deal, see also https://ec.europa.eu/commission/presscorner/detail/en/fs_19_6714. The consultation process ran until April 1, 2020.

than “brown” electricity, as had already been highlighted in the 2019 Evaluation of the Energy Taxation Directive.¹⁹⁵⁷

In the Commission’s view, however, specific policy options might be required for the aviation and maritime sectors. From a procedural perspective, the IIA envisaged a potential change in the legal basis of the Energy Taxation Directive.

Whereas the Energy Taxation Directive is currently based on Article 113 of the TFEU, the IIA suggested that the legal basis for the revision of the Energy Taxation Directive could be Article 192 of the TFEU, which focuses on environmental issues. The essential difference between these two provisions is that unanimity of all EU Member States is required under the former, whereas the latter only requires qualified majority voting in the Council.

The March–April 2020 consultation on the revised Energy Taxation Directive was followed by an official questionnaire-based public consultation that was open from July 22, 2020 to October 14, 2020. In total, 563 responses from 25 Member States and from five third countries were received, together with 129 position papers. An overwhelming majority of respondents agreed with the general EU objectives of fighting climate change and pollution and the application of these objectives to the revision of the Energy Tax Directive.

Most respondents agreed that the Energy Tax Directive revision should:

- (i) Take into account greenhouse gas emissions in the definition of rates (which should also be expressed in energy content rather than in volume); and
- (ii) Introduce incentives for alternative energy sources such as clean hydrogen and sustainable biofuels.

Besides the public consultation, direct consultations with Member States and other stakeholders have taken place, including requests for input in view of the computation of effective tax rates, as well as with other stakeholders.

Against this backdrop, on July 14, 2021, as part of the European Green Deal and the “Fit for 55” legislative package,¹⁹⁵⁸ the Commission launched a Proposal for a Council Directive restructuring the Union framework for the taxation of energy products and electricity (recast) (the “2021 Proposal.”)

The 2021 Proposal leaves unaffected the provisions of the Energy Tax Directive that define:

- (i) The taxable energy products;

- (ii) The uses that make them subject to tax and the minimum levels of taxation applicable to each product depending on whether it is used as propellant, for certain industrial; and

- (iii) Commercial purposes for heating.

The 2021 Proposal aims at:

- (i) Providing an adapted framework contributing to the EU 2030 targets and climate neutrality by 2050 in the context of the European Green Deal (which would involve aligning taxation of energy products and electricity with EU energy, environment and climate policies thus contributing to the EU efforts to reduce emissions);

- (ii) Providing a framework that preserves and improves the EU internal market by updating the scope and the structure of rates as well as by rationalizing the use of tax exemptions and reductions by Member States; and

- (iii) Preserving the capacity to generate revenues for the budgets of the Member States.

These objectives are to be achieved by:

- (i) Switching from volume to energy content-based taxation;
- (ii) Eliminating incentives for fossil fuel use; and
- (iii) Introducing a ranking of rates according to their environmental performance.

Moreover, the current tax structure should be simplified by grouping energy products (used as motor or heating fuels) and electricity into categories and by ranking them according to their environmental performance, where the “environmental performance” is defined in relation to other EU policies under the European Green Deal and, in particular, to the remainder of the proposals in the Fit for 55 package.

According to this ranking, conventional fossil fuels, such as gas oil and petrol, which are considered to be the most-polluting types of energy, would be taxed at the highest minimum rate (the reference rate), i.e., €10.75/GJ when used as a motor fuel and €0.9/GJ when used for heating.

The next category of rates applies to fuels that are fossil-based but are less harmful and still have some potential to contribute to decarbonization in the short and medium terms. As such, only two-thirds of the reference rate would apply for a transitional period of 10 years, i.e., a minimum rate of €7.17/GJ when used for motor fuel and €0.6/GJ when used for heating. Following this transitional period, they would be taxed at the same rate as conventional fossil fuels, i.e., the full reference rate.

The next category is that of sustainable but not advanced biofuels. To reflect their contribution to decarbonization, 50% of the reference rate would apply, i.e., a minimum rate of €5.38/GJ when used as motor fuel and €0.45/GJ when used for heating. The lowest minimum rate would apply to electricity, regardless of its use, advanced biofuels, bioliquids, biogases and hydrogen of renewable origin, i.e., €0.15/GJ. The rate applicable to this group was set significantly below the reference rate as electricity and these fuels could drive the EU’s clean energy transition towards achieving the objectives of the European Green Deal and ultimately climate neutrality by 2050. In

¹⁹⁵⁷ European Commission, Commission Staff Working Document — Evaluation of Council Directive 2003/96/EC of October 27, 2003 restructuring the Community framework for the taxation of energy products and electricity, SWD (2019) 329 final; see <https://taxation-customs.ec.europa.eu/system/files/2019-09/energy-tax-summary-report-2019.pdf>.

¹⁹⁵⁸ The package refers to a set of proposals adopted by the EU Commission on July 14, 2021 to make the EU’s climate, energy, land use, transport and taxation policies fit for reducing net greenhouse gas emissions by at least 55% by 2030, compared to 1990 levels. The proposals combine: application of emissions trading to new sectors and a tightening of the existing EU Emissions Trading System; increased use of renewable energy; greater energy efficiency; a faster roll-out of low emission transport modes and the infrastructure and fuels to support them; an alignment of taxation policies with the European Green Deal objectives; measures to prevent carbon leakage; and tools to preserve and grow our natural carbon sinks. See Architecture Factsheet: https://ec.europa.eu/commission/presscorner/detail/en/fs_21_3671.

some sectors, mainly in those that may currently benefit from total exemptions, such as aviation or heating fuels for non-vulnerable households, transition periods would apply to mitigate the economic and social costs of introducing taxation. Low-carbon hydrogen and other low-carbon fuels would also benefit from the minimum rate of €0.15/GJ for a transitional period of 10 years following which they would be subject to a minimum rate of €5.38/GJ.

Unlike under the current regime, the above minimum rates would be adjusted annually by the Commission by way of a delegated act, to reflect changes in the harmonized index of consumer prices excluding energy and unprocessed food as published by Eurostat. Energy products and electricity used for chemical reduction and in electrolytic and metallurgical processes would be excluded from taxation.

The 2021 Proposal also includes the possibility to exempt vulnerable households from taxation of heating fuels for a period of 10 years and introduces a transitional period of 10 years for attaining the minimum rate of taxation. Member States could also grant reductions not below the minima to heating fuels for all households. It would be up to Member States to decide on the use of tax revenues, and they could further ensure fairness by using those revenues to mitigate the social impact.

The 2021 Proposal extends the taxation to certain previously exempted products, uses and sectors.

This includes, in particular:

- (i) Kerosene used as fuel in the aviation industry, specifically for intra-EU passenger flights (the excise duty for aviation fuel would be increased gradually over a transitional period of 10 years, after which the reference rate (i.e., the highest minimum rate and the rate applicable to petrol used in road transport) would apply);
- (ii) Heavy oil used in the maritime industry, specifically in intra-EU ferry, fishing and freight vessels; and
- (iii) The use of energy for mineralogical processes.

To encourage a cleaner energy transition, sustainable and alternative fuels would benefit from a zero rate minimum tax rate for a transitional period of 10 years when used for air and maritime/fishing navigation.

As the current energy taxation framework leaves significant scope for the introduction of national exemptions/reductions for specific energy products/sectors by individual Member States, leading in practice to a *de facto* favoring of the use of fossil fuels in the EU (such as various reductions for diesel) and contributing to fragmentation of the EU's Single Market (given the different rates applicable to energy use across Member States,) the Commission proposed to phase out most of these exemptions and to revise the legislation in a way which leaves much less leeway for Member States to apply taxes which are below the minimum harmonized rates.

In terms of legislative procedure, given that the 2021 Proposal concerns the harmonization of taxation (more specifically, that of excise duties) rather than environmental issues (as was suggested in the II.A., see above), its adoption will require unanimity in the Council (effectively, unanimity among all EU Member States) and the EU Parliament will have to be consulted.

In the Council, some opposition and requests for the softening of the 2021 Proposal can be expected, in particular, from Central and Eastern European Member States as the 2021 Proposal is likely to place an additional burden on their national economies.

The 2021 Proposal envisaged the application of the new rules from January 1, 2023 but it is still currently pending.

On June 12, 2025, the General Secretariat of the Council of the European Union published the Presidency Progress Report on the Proposal.¹⁹⁵⁹ The Report noted that in the first half of 2025 three sets of full texts on the Proposal had been prepared, with the most recent being submitted to the Working Party on Tax Questions (Indirect Taxation — Excise Duties/Energy Taxation) on May 20, 2025. Clarifications had also been provided on the interpretation and scope of key concepts included in the ETD Proposal, such as “single use” and “different single use.” The Report emphasizes that further work will be necessary to reconcile the positions of the Member States’ delegations. It also acknowledges that some technical adjustments and legal scrutiny of the text will be needed.

D. Administrative Cooperation in the Field of Excise Duties

1. General

Council Regulation (EU) No. 389/2012 of May 2, 2012 on administrative cooperation in the field of excise duties (EACR) came into force in July 2012, replacing Council Regulation (EC) No. 2073/2004.¹⁹⁶⁰

The EACR clarifies and harmonizes arrangements for;

- (i) The registration of economic operators;
- (ii) The exchange of information; and
- (iii) The production of operational statistics.

The main driver for the adoption of the EACR, however, has beyond any doubt been the duty of the Commission and the Member States to maintain and develop the EU Excise Movement and Control System (EMCS), i.e., the computerized system for monitoring movements of excise goods under suspension of excise duty within the European Union.

The EMCS was put in place based on Decision No. 1152/2003/EC of the European Parliament and of the Council of June 16, 2003 on computerizing the movement and surveillance of excisable products. The EMCS supports a faster, more integrated approach to enabling Member State Authorities to control the movement of excise goods, based on automated risk analysis (see third recital of Decision 1152/2003/EC).

Council Regulation (EC) No. 2073/2004 provided a legal basis for an earlier Phase of the EMCS project, to support computer assisted manual procedures (Phase 0 of EMCS), pending the automation of support for administrative cooperation in Phase 2 and Phase 3 of the EMCS.

¹⁹⁵⁹ Interinstitutional File: 2021/0213 (CNS); 7819/25.

¹⁹⁶⁰ See also Commission Implementing Regulation (EU) No. 612/2013 of June 25, 2013, on the operation of the register of economic operators and tax warehouses, related statistics and reporting pursuant to Council Regulation (EU) No. 389/2012 on administrative cooperation in the field of excise duties.

Articles concerning the use of the economic operator registration system:

- (i) The System of Exchange of Excise Data (SEED);
- (ii) The Early Warning System for Excise (EWSE); and
- (iii) The Movement Verification System (MVS),

provided a legal basis for the use of these tools, alongside more general articles on Requests for Information, Automatic Exchange and Spontaneous Exchange that were derived from earlier legislation in the area of Administrative Cooperation (i.e., Council Directive 77/799/EEC, and certain provisions of Council Directive 92/12/EEC).

That legislative framework became obsolete as a result of:

- (i) The further development of EMCS and associated changes (such as developments in SEED, economic operator authorizations (SEED-on-Europa));
- (ii) The automatic exchange of messages between economic operators and Member State administrations for the reporting of exceptional situations (for example, the results of road controls, reports of exceptions made by economic operators and definitive interruptions of movements);
- (iii) The statistics and reporting service as part of the EMCS project (Central Services/Management Information System Excise or CS/MISE).

Given the scope of the changes referred to above, to provide a legal basis for the administrative cooperation functions of EMCS and to create a more coherent document, the Commission proposed in 2011 to replace Council Regulation (EC) No. 2073/2004 entirely with what eventually became the EACR.

The recitals of the EACR are self-explanatory in this respect. After repeating that the completion of the internal market continues to require a system of administrative cooperation in the field of excise duties encompassing all aspects of legislation concerning the application of excise duties to the goods referred to in Article 1 of the Horizontal Directive,¹⁹⁶¹ the recitals emphasize that it is essential that the role of electronic means in the exchange of information be enhanced. These requirements can best be met through the more systematic use of the computerized system established under Decision No. 1152/2003/EC (see above). Moreover, the exchange of information in excise matters is necessary to establish a true picture of the excise affairs of certain persons. However, at the same time, Member States are not at liberty to engage in “fishing expeditions” or to request information that is unlikely to be relevant to the excise affairs of a given person or ascertainable group or category of persons.

The EACR has been amended by Council Regulations:

- (i) (EU) No 517/2013 of May 1, 2013 (accession of Croatia);
- (ii) (EU) 2020/261 of December 19, 2019;

¹⁹⁶¹ The general Excise Directive — also referred to as the “Horizontal” Directive — is Council Directive (EU) 2020/262 of December 19, 2019 laying down the general arrangements for excise duty (recast); see the discussion at XVIII.B., above.

(iii) (EU) 2021/774 of May 10, 2021; and

(iv) (EU) 2023/246 of January 30, 2023.

Commission Implementing Regulation (EU) 2016/323, which entered into force on April 1, 2016, lays down detailed rules on cooperation and the exchange of information between Member States regarding excise goods pursuant to the EACR (see XVIII.D.10., below).

2. Institutional Framework

The EACR sets out the terms under which the competent authorities in the Member States for the application of the legislation on excise duties are to cooperate with each other, and with the Commission, to ensure compliance with that legislation and, to that end, lays down rules and procedures to enable the competent authorities of the Member States to cooperate and to exchange, by electronic means or otherwise, information necessary to ensure the correct application of legislation.¹⁹⁶²

As regards the institutional framework for achieving these objectives, similar rules and obligations with respect to:

- (i) “Competent authority;”
- (ii) “Central liaison office;”
- (iii) “Liaison department;” and
- (iv) “Competent officials”

apply as in the area of VAT administrative cooperation (see XVII.N.1., above).

3. Information or Documents Obtained with the Authorization or at the Request of the Judicial Authority

The communication to the competent authority of another Member State of information or documents obtained by a competent authority with the authorization, or at the request, of a judicial authority is subject to the prior authorization of the judicial authority if such authorization is required under national law. Where, in the case of a request for information, the judicial authority refuses such authorization to the requested authority, the latter will inform the requesting authority accordingly.¹⁹⁶³

4. Cooperation on Request

At the request of the requesting authority, the requested authority is obliged to communicate the information necessary to ensure the correct application of the legislation on excise duties, including any information relating to a specific case or specific cases, in particular concerning movements of excise goods within the European Union.¹⁹⁶⁴

For the purposes of communicating such information, the requested authority is to arrange for the conduct of any administrative enquiries necessary to obtain the information. The re-

¹⁹⁶² Council Regulation (EU) No. 389/2012 of May 2, 2012 on administrative cooperation in the field of excise duties (EACR), Art. 1.

¹⁹⁶³ EACR, Art. 7.

¹⁹⁶⁴ “A movement of excise goods within the Union” means the movement between two or more Member States of excise goods under suspension of excise duty within the meaning of Directive 2008/118/EC, Chapter IV or of excise goods after release for consumption within the meaning of Directive 2008/118/EC, Chapter V, Sec. 2 (EACR, Art. 2).

quest may include a reasoned request for a specific administrative enquiry. If the requested authority decides that no administrative enquiry is necessary, it immediately informs the requesting authority of the reasons for its decision. To obtain the information requested or to conduct the administrative enquiry requested, the requested authority or any administrative authority to which it has recourse proceeds as though acting on its own account or at the request of another authority in its own Member State. The requested authority may request the requesting authority to provide feedback on the follow-up action taken by the requesting Member State based on the information provided by the requested authority.¹⁹⁶⁵

Requests for information and administrative enquiries, as well as replies to such requests, must be exchanged using the mutual administrative assistance document (or, where the computerized system is unavailable, the fallback mutual administrative assistance document).

The “mutual administrative assistance document” is a document established within the EMCS that meets the structure and content requirements defined by the Commission. Where the use of the mutual administrative assistance document is impractical, the exchange of messages may, exceptionally, be carried out in whole or in part by other means. In such cases, the message must be accompanied by an explanation of why the use of the mutual administrative assistance document was impractical.¹⁹⁶⁶

Documents, whatever their content, to be provided for exchange of information purposes are in principle to be attached to the mutual administrative assistance document. The provision of original documents is mandatory only where such documents are necessary for the purposes pursued by the requesting authority and where providing them is not contrary to the provisions applicable in the Member State of the requested authority.¹⁹⁶⁷

The requested authority must provide the information as quickly as possible and, in any event, no later than three months following the date of receipt of the request. However, where the requested authority is already in possession of the information, the time limit is reduced to one month. Where the requested authority is unable to respond to the request within the applicable time limit, it informs the requesting authority using a mutual administrative assistance document of the reasons for its failure to do so and indicates when it expects to be able to respond. In certain special categories of cases, different time limits may be agreed between the requested and requesting authorities.¹⁹⁶⁸

The procedure regarding presence in administrative offices and simultaneous controls for excise duty purposes is largely the same as that which applies in the context of administrative cooperation in the field of VAT (see XVII.N.1., above).¹⁹⁶⁹

5. *Exchange of Information Without Prior Request*

The exchange of information without prior request can be mandatory or optional. While Member States are obliged to

take the necessary administrative and organizational measures to facilitate such exchanges, they are obliged neither to impose any new obligations on persons with respect to the collection of information nor to bear any disproportionate administrative burden in this respect.¹⁹⁷⁰

a. *Mandatory Exchange of Information*

The competent authority of each Member State must forward to the competent authorities of all other Member States concerned, without prior request and by means of regular or event-driven automatic exchange, the information necessary to ensure the correct application of the legislation on excise duties where:

- (i) An irregularity or an infringement of the legislation has occurred, or is suspected to have occurred, in another Member State;
- (ii) An irregularity or an infringement of the legislation that has occurred, or is suspected to have occurred, in the territory of one Member State may have repercussions in another Member State;
- (iii) There is a risk of fraud or a loss of excise duty in another Member State;
- (iv) The total destruction or irretrievable loss of excise goods has occurred; or
- (v) An exceptional event has occurred during a movement of excise goods within the Union that is not provided for in the Horizontal Directive and that may affect the calculation of the liability to excise duty of an economic operator.¹⁹⁷¹

The information is in principle forwarded through the EMCS. The Commission is to adopt implementing acts to determine:

- (i) The exact categories of information to be exchanged (which must, with respect to natural persons, include data such as their name, surname, street name, street number, postcode, city, Member State, tax or other identifying number, product code or description and other connected personal data, when available);
- (ii) The frequency of regular exchange and the time limits for event-driven exchange for each category of information;
- (iii) The structure and content of the mutual administrative assistance document; and
- (iv) The form and content of the fallback mutual administrative assistance document.

b. *Optional Exchange of Information*

The competent authorities of the Member States may, in circumstances not covered by the mandatory exchange of information requirements, forward to each other, without prior request, by means of spontaneous exchange, any information necessary to ensure the correct application of the legislation on

¹⁹⁶⁵ EACR, Art. 8.

¹⁹⁶⁶ EACR, Art. 9.

¹⁹⁶⁷ EACR, Art. 10.

¹⁹⁶⁸ EACR, Art. 11.

¹⁹⁶⁹ EACR, Arts. 12–13.

¹⁹⁷⁰ EACR, Arts. 17–18.

¹⁹⁷¹ EACR, Art. 15.

excise duties of which they are aware.¹⁹⁷² The Commission is to adopt implementing acts in this respect.

6. Limitations on Exchange of Information

See the discussion at XVII.N.1., above in the context of administrative cooperation in the field of VAT, which applies, *mutatis mutandis*.¹⁹⁷³ A request for assistance may be subject to a minimum threshold based on the excise duty potentially due.¹⁹⁷⁴

7. Storage and Exchange of Electronic Information on Economic Operators

Each Member State is required to maintain an electronic database containing:

(i) A register of authorized warehouse keepers, registered consignees and registered consignors and certified consignors and certified consignees, all within the meaning of the Horizontal Directive (collectively, “economic operators;”) and

(ii) A register of premises authorized as tax warehouses.¹⁹⁷⁵ Such registers must contain:

(i) The unique excise number issued by the competent authority with respect to each economic operator or premises;

(ii) The name and address of each economic operator or premises;

(iii) The excise product category (CAT) and/or the excise product code (EPC) of the products covered by the authorization referred to in Annex II, code list 10 of Commission Delegation Regulation (EU) 2022/1636;¹⁹⁷⁶

(iv) The identification of the central excise liaison office or the excise office from which further information may be obtained;

(v) The date as of which the authorization is valid, is amended and, where applicable, ceases to be valid;

(vi) For authorized warehouse keepers, the tax warehouse or the list of tax warehouses to which the warehouse keeper’s authorization applies and, if applicable under national legislation, an indication that the warehouse keeper is authorized to:

(a) Omit the details of the consignee at the time of dispatch;

(b) Split a movement into two or more movements,¹⁹⁷⁷ or

(c) Have excise goods moved to a place of direct delivery;¹⁹⁷⁸

(vii) For registered consignees, if applicable under national legislation, an indication that the consignee is authorized to have excise goods moved to a place of direct delivery and that he/she is acting as a certified consignee;

(viii) For (certain) registered consignees, the content of the authorization regarding the quantity of excise goods, the period of time for which the authorization is valid and, where applicable, the identity of the consignor in the Member State of dispatch;

(ix) For tax warehouses, the authorized warehouse keeper or list of authorized warehouse keepers for whose use the tax warehouse is authorized;

(x) For registered consignors, an indication that the registered consignor is authorized to omit the details of the consignee at the time of dispatch and an indication that he/she is acting as a qualifying consignor;

(xi) For certified consignors sending excise only occasionally, the quantity of excise goods, the identity of the consignee in the Member State of destination and the period of time for which the temporary certification is valid; and

(xii) For certified consignees receiving exchange goods only occasionally, the quantity of excise goods, the identity of the consignor in the Member State of dispatch and the period of time for which the temporary certification is valid.¹⁹⁷⁹

The central excise liaison office or a liaison department of each Member State is to ensure that the information contained in the national registers is complete, accurate and up-to-date.¹⁹⁸⁰

The information contained in the respective national registers concerning “economic operators” (see above) engaged in moving excise goods referred to in Chapter IV and Chapter V, Section 2 of the Horizontal Directive is automatically exchanged via a central register (the “Central Register.”) The Central Register is operated by the Commission as part of the computerized system in a manner that ensures at all times a correct up-to-date view of all national registry data provided by all Member States.¹⁹⁸¹

At the same time, the Commission is also to ensure that persons involved in the movement of excise goods referred to in Chapter IV and Chapter V, Section 2 of the Horizontal Directive can obtain confirmation by electronic means of the validity of excise numbers held in the Central Register, and the central excise liaison offices or liaison departments of Member States are to ensure that economic operators can obtain confirmation of the information held about them and can have any inaccuracies corrected.¹⁹⁸²

Each Member State must keep the information concerning the movement of excise goods within the Union and the records contained in the national registers referred to above for at least five years from the end of the calendar year in which the movement began, so that the information can be used for the proce-

¹⁹⁷² EARC, Art. 16.

¹⁹⁷³ EACR, Art. 25.

¹⁹⁷⁴ EACR, Art. 27(1).

¹⁹⁷⁵ EARC, Art. 19(1).

¹⁹⁷⁶ Commission Delegated Regulation (EU) 2022/1636 of July 5, 2022 supplementing Council Directive (EU) 2020/262 by establishing the structure and content of the documents exchanged in the context of movement of excise goods, and establishing a threshold for the losses due to the nature of goods.

¹⁹⁷⁷ Cf. Horizontal Directive, Art. 23.

¹⁹⁷⁸ Cf. Horizontal Directive, Art. 17(2).

¹⁹⁷⁹ EACR, Art. 19(2).

¹⁹⁸⁰ EACR, Art. 19(3).

¹⁹⁸¹ EACR, Art. 19(4). Detailed rules are set out in Chapter IV and Chapter V, Section 2 of the Horizontal Directive of December 19, 2019.

¹⁹⁸² EACR, Art. 20(1) and (2).

dures provided for in the EACR. The period may be limited to three years with respect to information entered into the national registers before July 1, 2012. Information collected through the computerized system must be kept in that system in a way that makes it possible to retrieve and further process the information within the system in response to a request for information.¹⁹⁸³

8. Confidentiality; Evidential Value of Information Obtained

See the discussion at XVII.N.1., above in the context of administrative cooperation in the field of VAT, which applies, *mutatis mutandis*.¹⁹⁸⁴

9. Relations with Third Countries

A competent authority of a Member State that receives information from a third country may pass that information on to the competent authority of any Member State that might be interested in it and, in particular, to any competent authority that requests it, to the extent permitted by assistance arrangements with that particular third country. Such information may also be passed on to the Commission whenever it is in the interest of the European Union for the purposes of the EACR.

Where the third country concerned has given a legal undertaking to provide the assistance required to gather evidence of the irregular nature of transactions that appear to contravene the legislation on excise duties, information obtained under the EACR may be communicated by the competent authority of a Member State to that third country (in accordance with that Member State's national law regarding transfers of personal data to third countries) for the purposes of the correct application of excise duties or similar taxes, duties and charges applicable in the third country with the consent of the competent authorities that supplied the information in accordance with their national law.¹⁹⁸⁵

10. Commission Reporting to European Parliament and Council

Every five years from the date of entry into force of the EACR and based, in particular, on the information provided by the Member States, the Commission must report to the Eu-

ropean Parliament and the Council on the application of the EACR.¹⁹⁸⁶

11. Commission Implementing Regulation (EU) 2016/323 — Detailed Rules Regarding Goods Under Duty Suspension

On February 24, 2016, the Commission adopted Commission Implementing Regulation (EU) 2016/323 laying down detailed rules on cooperation and exchange of information between Member States regarding goods pursuant to the EACR.

For the purposes of cooperation and exchange of information between Member States regarding goods referred to in Chapter IV and Chapter V, Section 2 of the Horizontal Directive, this Regulation lays down detailed rules concerning:

- (i) The structure and content of the mutual administrative assistance documents exchanged through the computerized system referred to in Article 2(8) of the EACR for the purposes of Articles 8, 15 and 16 of the EACR;
- (ii) The structure and content of communications of feedback on follow-up action taken as a result of cooperation on request or of the optional communication of information;
- (iii) The rules and procedures to be used by competent authorities exchanging mutual administrative assistance documents; and
- (iv) The structure and content of fallback mutual administrative assistance documents and the rules and procedures relating to their use.

Regulation (EU) 2016/323 entered into force on April 1, 2016.

It has been subsequently amended by Commission Implementing Regulations:

- (i) (EU) 2018/505 of March 7, 2018;
- (ii) (EU) 2019/2223 of December 13, 2019;
- (iii) (EU) 2021/2263 of December 17, 2021; and
- (iv) (EU) 2022/2573 of December 13, 2022.

¹⁹⁸³ EACR, Art. 21.

¹⁹⁸⁴ EACR, Arts. 28 and 30, respectively.

¹⁹⁸⁵ EACR, Art. 32.

¹⁹⁸⁶ EACR, Art. 37.

XIX. Custom Duties

A. General

Executive Summary

This Section discusses the internal aspect of the EU customs union, i.e. the prohibition on the imposition between Member States of customs duties on imports and exports and all charges having equivalent effect (XIX.B., below) and its logical complement, i.e. the elimination of discriminatory and protectionist taxation (XIX.C., below), including the demarcation issues between both.

The Section continues with a brief discussion of: the basic principles of the external aspect of the EU customs union, i.e. the common customs tariff (highlighting the Combined Nomenclature, the TARIC, the Harmonized System and the related six interpretation principles or “rules”); and free trade agreements and the generalized system of preferences.

As noted in II.A., the TFEU takes a two-pronged approach to addressing the free movement of goods, i.e.:

(i) The establishment of a customs union (Article 28 of the TFEU), involving:

- The prohibition between Member States of customs duties on imports and exports and all charges having equivalent effect (Article 30 of the TFEU);
- The adoption of a common customs tariff that may apply to goods coming into the European Union from third countries; and
- The elimination of discriminatory and protectionist taxation (Article 110 of the TFEU); and

(ii) The removal of quantitative restrictions on trade and all measures having equivalent effect, covering both:

- Imports (Article 34 of the TFEU); and
- Exports (Article 35 of the TFEU).

The discussion below focuses on (i) only, with (ii) addressed in II.E.2., above.

B. Prohibition Between Member States of Customs Duties on Imports and Exports and All Charges Having Equivalent Effect

1. General

Article 28(1) of the TFEU stipulates that “[t]he EU shall be based upon a customs union which shall cover all trade in goods and which shall involve the prohibition between Member States of customs duties on imports and exports and of all charges having equivalent effect, and the adoption of a common customs tariff in their relations with third countries.”

The provision thus encompasses two distinct but interconnected aspects:

(i) The elimination of customs duties and charges having equivalent effect between Member States (the internal aspect of the customs union); and

(ii) The adoption of a common customs tariff (the external aspect of the customs union).

The external aspect is dealt with in XIX.D., below.

In this context, “goods” means products that can be valued in money that are capable, as such, of forming the subject of commercial transactions.¹⁹⁸⁷

Article 30 of the TFEU elaborates on Article 28 by prohibiting customs duties on imports and exports and charges having equivalent effect between Member States. This prohibition also applies to customs duties of a fiscal nature.

All customs duties between Member States were removed in advance of the 1969 deadline for the end of the transitional period, while the common customs tariff in relation to third countries was also established ahead of schedule. As a result, the (current) emphasis of Article 30 is no longer on customs duties *sensu stricto*, but rather on the prohibition of charges having equivalent effect to customs duties.

Article 30 is directly effective. In *Van Gend and Loos*,¹⁹⁸⁸ the Court of Justice of the European Union (CJEU) expressly confirmed that the wording of Article 30 contained a clear and unconditional prohibition that was not a positive obligation but a negative obligation. This obligation, moreover, was not qualified by any reservation on the part of states that would make its implementation conditional on a positive legislative measure enacted under national law. The very nature of this prohibition made it ideally suited to produce direct effects in the legal relationship between Member States and their subjects.

As the customs union necessarily entails the free movement of goods between the Member States, that freedom could not itself be complete if it were possible for the Member States to impede or interfere in any way with the movement of goods in transit. As a result, it is necessary to acknowledge the existence of a general principle of freedom of transit of goods within the European Union.¹⁹⁸⁹ A Member State would contravene that principle if it were to apply transit duties or other charges imposed with respect to transit of goods through its territory.¹⁹⁹⁰

It follows that a charge:

(i) Triggered by the carriage of goods; and

(ii) Imposed not on a product as such, but on a necessary activity in connection with the product,

may fall within the scope of Article 30 of the TFEU.¹⁹⁹¹

The CJEU deemed such a charge to be imposed on products where it was levied on the transport of goods or the use

¹⁹⁸⁷ Case C-7/68, *Commission v. Italy*; see, e.g., articles of an artistic, historic, archaeological or ethnographic nature (Case C-7/68, *Commission v. Italy*); gold and silver collectors' coins, provided the coins are not in circulation as legal tender (Case C-7/78, *Thompson*); waste (Case C-2/90, *Commission v. Belgium*); and electricity (Case C-393/92, *Almelo*).

¹⁹⁸⁸ Case C-26/62, *Van Gend and Loos*.

¹⁹⁸⁹ Case C-173/05, *Commission v. Italy*.

¹⁹⁹⁰ Case 266/81, *SIOT*.

¹⁹⁹¹ Case C-206/06, *Essent Netwerk Noord and Others*, C-206/06.

of roads and had to be paid by the person operating the heavy goods vehicle concerned.¹⁹⁹²

While Article 30 refers to “charges having equivalent effect between Member States,” as early as 1969, the CJEU considered that both the unity of the EU customs territory and the uniformity of the common commercial policy would be seriously undermined if the Member States were authorized unilaterally to impose charges having equivalent effect in trade with nonmember countries.¹⁹⁹³

In an apparent reversal of its case law since 1969, the CJEU held in *Lamaire*¹⁹⁹⁴ that charges unilaterally imposed by a Member State (here, Belgium) with respect to imports and exports of products coming from or destined for nonmember countries were permissible under EU law. However, in *Aprile*,¹⁹⁹⁵ one year later, the CJEU reverted to its earlier position, which appears to have been confirmed in subsequent decisions.¹⁹⁹⁶

Closely related to the above is the issue of whether the prohibition laid down in Article 30 also extends to charges levied by reason of the dispatch of goods within one and the same Member State. In *Lancry*,¹⁹⁹⁷ a case involving French dock dues (*octrois de mer*), the CJEU considered that the abolition of duties and charges having equivalent effect between regions and municipalities is implicit in Article 30 of the TFEU. The decision in *Lancry*, which has since been underscored in, *inter alia*, *Simitzi*¹⁹⁹⁸ and *Camara de Comercio de Ceuta*,¹⁹⁹⁹ arguably presents some degree of difficulty as it seems to depart from the general principle that the rules of EU law (especially those relating to the free movement of goods, services and persons) are not applicable to domestic situations. Given the circumstances, however, such a departure was (and continues to be) the only way to resolve the paradox of a single market in which barriers to trade between Member States are prohibited, while barriers to trade between different areas of the same Member State would be considered to be immaterial.

Without prejudice to the discussion under XIX.B.3., below, charges having equivalent effect to customs duties are prohibited irrespective of the purpose for which they were introduced and the destination of the revenue from them.²⁰⁰⁰

2. Charges Having Equivalent Effect to Customs Duties — Concept

The TFEU does not define the concept of “charges having equivalent effect.”

The CJEU provided the first definition of the concept in *Commission v. Luxembourg and Belgium*,²⁰⁰¹ describing charges having equivalent effect as “duties whatever their description or technique, imposed unilaterally, which apply specifically to a product imported by a Member State but not to a similar national product and which by altering the price, have the same effect upon the free movement of goods as a customs duty.”

A more comprehensive definition was given in *Commission v. Italy*,²⁰⁰² where “charges having equivalent effect” were held to be “any pecuniary charge, however small and whatever its designation and mode of application, which is imposed unilaterally on domestic or foreign goods²⁰⁰³ by reason of the fact that they cross a frontier (...) even if it is not imposed for the benefit of the State, it is not discriminatory or protective in effect and if the product on which the charge is imposed is not in competition with any domestic product.”

According to the Court, a charge of that nature, imposed specifically on an imported product to the exclusion of a similar domestic product has, by altering the price of that product, the same restrictive effect on the movement of products as a customs duty.²⁰⁰⁴

Moreover, it follows from that definition that the essence of the legal concept in question lies in the effects that a specific pecuniary charge has on trade between Member States, i.e., that charge must have the same protectionist, and hence restrictive, effect as a customs duty. This is the case, in particular, where the charge leads to an artificial increase in the cost price of imported or exported goods in relation to national goods.

The formal aspects, including:

- (i) The designation;
- (ii) The amount;
- (iii) The structure;
- (iv) The methods of collection;
- (v) The destination;
- (vi) The recipient of the proceeds; and

¹⁹⁹² Case C-90/94, *Haahr Petroleum*, C-90/94. For example, a tax on motor vehicles that must be paid by persons operating heavy goods vehicles registered in Turkey and in transit through Hungarian territory constitutes a charge having equivalent effect to a customs duty (Case C-65/16, *Istanbul Lojistik*).

¹⁹⁹³ Joined Cases 2/69 and 3/69, *Sociaal Fonds voor de Diamantarbeiders v. Brachfield*; see also Joined Cases 37/73 and 38/73, *Indiamex and De Belder*; Case C-266/81, *SIOT*.

¹⁹⁹⁴ Case C-130/93, *Lamaire*.

¹⁹⁹⁵ Case C-125/94, *Aprile*.

¹⁹⁹⁶ See, e.g., Case C-173/05, *Commission v. Italy*, concerning a charge on a gas pipeline infrastructure linked to trans-Mediterranean gas pipelines transporting natural gas from Algeria for the purpose of distribution and consumption in Italy, and also export to other Member States.

¹⁹⁹⁷ Joined Cases C-363/93 and 407/93 to 411/93, *Lancry*.

¹⁹⁹⁸ Joined Cases C-485/93 and 486/93, *Simitzi*.

¹⁹⁹⁹ Case C-45/94, *Camara de Comercio de Ceuta*.

²⁰⁰⁰ Case C-72/03 *Carbonati Apuani*; see also Case C-173/05, *Commission v. Italy*.

²⁰⁰¹ Joined Cases 2/62 and 3/62, *Commission v. Luxembourg and Belgium*.

²⁰⁰² Case 24/68, *Commission v. Italy*; see also Joined Cases 7 and 3/69, *Sociaal Fonds voor de Diamantarbeiders v. Brachfield*; C-72/03, *Carbonati*; Case 158/82, *Commission v. Denmark*; Case C-347/95, *UCAL*; Case C-63/90, *Legros*; Case C-293/02, *Jersey Produce Marketing Organisation*; Case C-517/04, *Koornstra*; Joined Cases C-393/04 and C-41/05, *Air Liquide Industries Belgium*; Case C-221/06, *Stadtgemeinde Frohnleiten en Gemeindebetriebe Frohnleiten*; see also Case C-90/94, *Haahr Petroleum*; Case C-213/96, *Outokumpu*; Case C-173/05, *Commission v. Italy*; Joined Cases C-290/05 and C-333/05, *Nádasdi and Németh*; Case C-254/13, *Orgacom*; and Case C-65/16, *Istanbul Lojistik*.

²⁰⁰³ A charge that is imposed not on a product as such, but on a necessary activity in connection with the product may fall within the scope of TFEU, Arts. 30 and 110 (see, e.g., Case C-221/06, *Stadtgemeinde Frohnleiten en Gemeindebetriebe Frohnleiten*).

²⁰⁰⁴ See Joined Cases 2 and 3/62, *Commission v. Luxembourg and Belgium*; Case 94/74 IGAV; Case 77/76, *Cucchi*.

(vii) The objectives pursued, are in fact irrelevant to the classification of a charge as a charge having equivalent effect, provided the charge in question is legally binding (“imposed unilaterally”).²⁰⁰⁵

More specifically, the reference to “any pecuniary charge” means that charges having equivalent effect relate only to fiscal measures, implying that other obstacles are within the scope of the provisions relating to nontariff barriers on the free movement of goods.

(i) The reference to “however small” emphasizes that there is no *de minimis* rule.

(ii) The reference to “whatever its designation and mode of application” indicates that the designation or mode of application of the duty is irrelevant.²⁰⁰⁶

(iii) The references to “not discriminatory or protective in effect” and “not in competition with any domestic products” contrast Article 30 of the TFEU with Article 110 of the TFEU (internal taxation — see II.B., above).

A charge falling within the definition set out above is prohibited, even if:

(i) It is not imposed for the benefit of the Member State concerned;

(ii) It has no discriminatory or protective effects; or

(iii) It applies to goods that are not in competition with domestic products.

For example, in *Legros*,²⁰⁰⁷ another case that concerned dock dues levied in the French overseas departments on goods brought into those territories, irrespective of their provenance and/or origin (which could be another Member State, a non-member country or even a region of France itself), the CJEU treated these dues as a charge having equivalent effect to a customs duty. The fact that the charge was also imposed on goods from other parts of France was held to be irrelevant.

The prohibition of customs duties on imports and exports and charges having equivalent effect between Member States is absolute. There are no derogations or mandatory requirements that could justify proportionate violations or allow a measure to be taken outside the scope of the prohibition. As such, any charge that falls within the scope of Article 30 of the TFEU is illegal.

3. “Out of Scope” Charges

The CJEU has (gradually) recognized, within the context of its judicial review process, that certain situations must be considered to be “out of scope” of the prohibition in Article 30

of the TFEU, i.e., should not be classified as charges having equivalent effect. However, the CJEU takes an extremely restrictive view of such situations.

a. Charges for Services Conferring a Benefit

A pecuniary charge is deemed to escape the prohibition in Article 30 of the TFEU if it represents payment for a service actually rendered to an economic operator of an amount proportionate to the service concerned.²⁰⁰⁸ While theoretically valid, case law demonstrates that the CJEU has been reluctant to accept this argument in practice.

*Commission v. Italy*²⁰⁰⁹ concerned a charge imposed by the Italian government on goods arriving in Italy, purportedly to enable the government to produce statistics subsequently made available to traders. On this basis, the Italian government argued that the charge imposed was a payment for the benefit that the traders received in the form of such statistics. The CJEU ruled that, for the argument to hold up, a specific benefit had to be received by individual traders. The fact that a general benefit might be conferred on a certain category of traders was insufficient — even if the competitive position of importers and exporters were to be particularly improved as a result, the statistics would still constitute an advantage so general and so difficult to assess that the disputed charge could not be regarded as consideration for a specific benefit actually conferred.

In *Cadsky v. ICE*,²⁰¹⁰ which concerned a charge imposed on Italian salad vegetables entering Germany from Italy, the German government attempted — unsuccessfully — to argue that the fact that the vegetables had passed inspection constituted a benefit to the trader, since German consumers would know that Italian vegetables were of good quality.

In *Ford España v. Spain*,²⁰¹¹ the charge at issue was calculated as a percentage of the value of the goods concerned. The CJEU held that, regardless of whether there was a specific benefit, a charge calculated in this way automatically constituted a breach of Article 30 of the TFEU. It follows that the use of “rule of thumb” calculations of an approximate nature (as in the case of charges levied based on the quantity or quality of the goods concerned) is incompatible with Article 30.

In *Bakker Hillegom*,²⁰¹² the CJEU provided further clarification holding that there was a direct link between the amount of a fee and the actual inspection with respect to which the fee was charged when the amount of the inspection fee was calculated based on:

(i) The duration of the inspection;

(ii) The number of persons required;

(iii) The cost of materials;

(iv) The cost of overheads,

or other similar factors, which did not preclude a fixed-rate assessment of inspection costs, such as, for example, a fixed hourly rate.

²⁰⁰⁵ Thus, e.g., in the context of an infringement action brought against Italy, the CJEU ruled that a tariff set by a professional association and given legal effect by statute did not constitute a charge having equivalent effect, since the use of the services to which that tariff applied was not compulsory (see Case C-119/92, *Commission v. Italy*).

²⁰⁰⁶ E.g., Case 24/68, *Commission v. Italy* (charges made for collecting statistics); Case 132/80, *United Foods* (charges made for health inspection with respect to products from other Member States); Case 132/82, *Commission v. Belgium* (charges for storage prior to completion of customs formalities); Case C-173/05, *Commission v. Italy* (charges on the use of gas pipelines designated as an environmental tax).

²⁰⁰⁷ Case C-163/90, *Legros*.

²⁰⁰⁸ See, *inter alia*, Case 63/74, *Cadsky*; Case 158/82, *Commission v. Denmark*; Case C-109/98, *CRT France International*.

²⁰⁰⁹ Case 24/68, *Commission v. Italy*.

²⁰¹⁰ Case 63/74, *Cadsky*.

²⁰¹¹ Case 170/88, *Ford España v. Spain*.

²⁰¹² Case C-111/89, *Bakker Hillegom*.

However, there was no direct link between the actual inspection and the amount of the fee when the calculation of the fee amount was based on the weight or invoice value of the products exported. Under a system of that sort, the fees therefore had to be regarded as charges having an equivalent effect and incompatible with Article 30 of the TFEU.

b. Charges for Services Required Under European Union or International Law

If a Member State is required to perform a service to comply with an obligation imposed on that State by EU law or international law, the Member State concerned is entitled to charge for providing the service, but it must establish that the charge is proportionate to the cost of providing the service.

However, as indicated in *Bauhuis v. Netherlands*,²⁰¹³ charges for services required under EU law or international law must be distinguished from charges for services that are merely “permitted.” The former are “allowable” under Article 30 whereas the latter are likely to constitute charges having equivalent effect unless they can be categorized as charged for services conferring a benefit (see XIX.B.3.a., above).

In *Commission v. Germany*,²⁰¹⁴ which concerned fees charged for inspections of live animals entering Germany where inspections were required by Directive 81/389, the CJEU held that such fees were not to be classified as charges having equivalent effect provided:

- (i) They did not exceed the actual costs of the inspections in connection with which they were charged;
- (ii) The inspections in question were obligatory and uniform for all the products concerned in the European Union;
- (iii) They were prescribed by EU law in the general interest of the Union; and
- (iv) They promoted the free movement of goods, in particular by neutralizing obstacles that could arise from unilateral inspection measures adopted in accordance with (now) Article 30 of the TFEU.

That being said, the inspection itself might be a nonfiscal barrier to trade even if there was no charge for it.

4. Demarcation Issues — Charges Having Equivalent Effect Versus Internal Taxation

See XIX.C.6., below.

C. Discriminatory and Protective Internal Taxation

1. General

The first paragraph of Article 110 of the TFEU prohibits Member States from imposing, directly or indirectly, on the products of other Member States, any internal taxation of any kind in excess of that imposed directly or indirectly on similar domestic products (“discriminative internal taxation.”)

The second paragraph of Article 110 prohibits Member States from imposing on products from other Member States

any internal taxation of such a nature that would afford indirect protection to other products (“protective internal taxation.”)

The purpose of Article 110 of the TFEU, taken as a whole, is to ensure the free movement of goods between Member States under normal conditions of competition, by eliminating all forms of protection that might result from the application of discriminatory internal taxation against products from other Member States, and to guarantee the absolute neutrality of internal taxation as regards competition between domestic and imported products.²⁰¹⁵

Thus, Article 110 is the logical complement to:

- (i) Article 28 (“EU customs union”) of the TFEU; and
- (ii) Article 30 (prohibition of customs duties and charges having equivalent effect between Member States) of the TFEU,

which would remain ineffective if they were not supplemented by the prohibition on differential internal tax treatment for various types of similar or competing products.

Internal taxation encompasses all indirect taxes, in particular turnover taxes and excise duties, charged directly or indirectly on products. Neither income taxes nor import duties come within the scope of Article 110 of the TFEU, as this provision refers specifically to internal taxes on products.

The fact that a tax or levy is:

- (i) Collected by a body of public law other than the State or is collected for its benefit; and
- (ii) A charge that is special or appropriate for a specific purpose

cannot prevent its falling within the scope of application of Article 110.²⁰¹⁶

The prohibitions laid down in Article 110 of the TFEU apply only with respect to “products.”

Savings deposits were held by the CJEU to be outside the scope of the definition of “products” as they were governed by:

- (i) Article 58(2) of the TFEU (liberalization of banking and insurance services connected with movements of capital); and
- (ii) Article 67 of the TFEU (free movement of capital).²⁰¹⁷

Although Article 110 of the TFEU refers only to “the products of other Member States,” the prohibition against discrimination also applies to products of third countries that are in free circulation in the Member States.²⁰¹⁸

Direct imports from third countries are not covered, unless they are the subject matter of treaty provisions in force between the European Union and the country of origin of the product concerned.²⁰¹⁹ Article 110 allows for reverse discrimination and

²⁰¹⁵ Case 323/87, *Commission v. Italy*; see also Case C-76/14, *Manea*, Case C-586/14, *Budişan* and Case C-676/21, *Veronsaajien oikeudenvalvontayksikkö*; Case C-349/22, *Autoridade Tributária e Aduaneira (Taxe sur les véhicules d'occasion importés)*, referring to Case C-402/09, *Tatu* and Case C-640/17, *dos Santos*.

²⁰¹⁶ Case 74/76, *Iannelli v. Meroni*.

²⁰¹⁷ Case 267/86, *Van Eijcke v. Aspa*.

²⁰¹⁸ Case 193/85, *Co-Frutta* (excise duty on bananas).

²⁰¹⁹ Case 148/77, *H. Hansen*; Joined Cases C-228 to 234, 339 and 353/90, *Simba and Others* (Italian consumption tax on fresh bananas imported from

²⁰¹³ Case 1/83, *Bauhuis v. Netherlands*.

²⁰¹⁴ Case 18/87, *Commission v. Germany*.

therefore it cannot be relied on by national producers in a particular Member State.²⁰²⁰

2. Discriminatory Internal Taxation

The application of the prohibition against discriminatory internal taxation laid down in the first paragraph of Article 110 of the TFEU requires a comparison to be made between:

- (i) The tax levied on domestic products; and
- (ii) The tax levied on similar imported products.

Consequently, to make an assessment for the purposes of this prohibition, it is necessary to take into account the following:

- (i) The origin of the products;
- (ii) The similarity between the products at issue; and
- (iii) Any factors of a discriminatory nature resulting in differential taxation to the detriment of the imported product.

a. “Similar” Products

The concept of “similar products” is controversial. Initially, similarity was deemed to exist where the products concerned could normally be considered as coming within the same fiscal, customs or statistical classification.²⁰²¹

In two decisions dated February 27, 1980,²⁰²² the CJEU moved away from these formal criteria, holding that the similarity concept had to be interpreted with sufficient flexibility.

According to the Court, similarity must be determined by examining whether the products in question:

- (i) Have similar characteristics; and
- (ii) Meet the same needs from the point of view of the consumer.

The test is, therefore, not whether products are strictly identical, but whether the use of the products is similar or comparable.²⁰²³

nonmember countries); Case C-130, *OTO* (Italian consumption tax on audio-visual and photo-optical-products imported from Japan).

²⁰²⁰ Case 68/79, *Just*.

²⁰²¹ Case 27/67, *Fink-Frucht*; see also Case 28/69, *Commission v. Italy* (“same classification for tax purposes”).

²⁰²² Case 168/78, *Commission v. France*; Case 169/78, *Commission v. Italy*.

²⁰²³ See the General Agreement on Tariffs and Trade (GATT) developments with respect to the concept of “like (or similar) products” appearing in a number of different GATT provisions: while the concept obviously encompasses same or identical products, other factors need to be taken into account, such as the composition and physical characteristics of the products, as well as whether the products at issue meet the same consumer needs. Specifically, as regards GATT, Art. III:2 (which is the GATT equivalent of TFEU, Art. 110), the World Trade Organization (WTO) Appellate Body, instead of relying predominantly on market-based characteristics such as consumer preferences, would seem to give certain weight to physical characteristics reminiscent of those employed to make tariff distinctions (such as color, raw materials and the presence of additives). This is explained by the juxtaposition of “like” products in the first sentence of Art. III:2 with “directly competitive” products in the second sentence of Art. III:2 — a juxtaposition that is also used in TFEU, Art. 110 — requiring the concept of “like product” to be given a very narrow reading in this particular context.

b. Differential Tax Treatment

Once it is established that products are “similar,” it must be determined whether there is any differential tax treatment to the detriment of the imported product.

The comparison between the tax levied on the domestic product and that levied on the similar imported product must be made having regard to:

- (i) The rate of the tax;
- (ii) The basis of assessment; and
- (iii) The detailed rules for the levying of tax.²⁰²⁴

In other words, once the similarity of the products has been established, the tax imposed must be identical, thus rendering the standard of nondiscrimination a strict one, with no room for a *de minimis* rule.

Discriminatory internal taxation may be direct or indirect.

A long list of cases relates to repeated, yet mostly unsuccessful attempts by the French government to tax imported luxury cars (*les belles étrangères*) more heavily than cars produced in France.²⁰²⁵

Similarly, a system that relies on the charging of higher taxation on a criterion that, by definition, can never be met by similar domestic products cannot be considered to be compatible with the prohibition on discrimination laid down in Article 110 of the TFEU. Such a system has the effect of excluding domestic products in advance from the heaviest taxation.²⁰²⁶

Likewise, the Court held that such differential taxation was incompatible with EU law if the products most heavily taxed were, by their very nature, imported products.²⁰²⁷

Conversely, a system that consists in conferring a tax advantage on a single product that represents the major portion of domestic production (in the case at hand, a preferential rate for aquavit and schnapps) to the exclusion of all similar (or competing) imported products is incompatible with Article 110 of the TFEU.²⁰²⁸

In the same vein, where the revenue from the tax concerned is intended to finance activities to the advantage of taxed domestic products (for example, through the granting of aid), the underlying tax — even if it is imposed on domestic and imported products alike based on the same criteria — may constitute discriminatory taxation. This will be the case, if the fiscal burden on the domestic products is neutralized by the advantages financed by the tax while the tax on the imported products constitutes a net burden.²⁰²⁹

²⁰²⁴ See, e.g., Case 77/69, *Commission v. Belgium* (different basis for assessment); Case 55/79, *Commission v. Ireland* (deferred payment of tax only available to national producers); Case C-402/09, *Tatu* (tax on secondhand cars from other Member States exceeding the residual tax incorporated in the value of similar secondhand motor vehicles already registered in the national territory which, having been taxed at the time of such registration, are not taxed when sold secondhand; see also, *inter alia*, Case C-345/93, *Fazenda Publica and Ministerio Publico v. Americo Joao Nunes Tadeu*).

²⁰²⁵ See, e.g., Case 112/84, *Humblot*; Case 433/85, *Feldain*; see however Case C-113/94, *Casarin*.

²⁰²⁶ Case 319/81, *Commission v. Italy*.

²⁰²⁷ Case 106/84, *Commission v. Denmark*.

²⁰²⁸ Case 68/79, *Just*.

²⁰²⁹ Case 73/79, *Commission v. Italy*.

3. Protective Internal Taxation

The prohibition against protective internal taxation laid down in the second paragraph of Article 110 of the TFEU covers all forms of indirect tax protection in the case of products that, without being similar, are nonetheless in competition, even partially, indirectly or potentially, with products of the importing country.²⁰³⁰

The prohibition in the second paragraph of Article 110 of the TFEU is complementary to that set forth in the first paragraph of Article 110 and has a much wider scope. Precisely due to the difficulty of making a sufficiently precise comparison between the products in question, the second paragraph of Article 110 employs a more general criterion, i.e., the indirect protection afforded by a domestic tax system.

As such, it is sufficient for the purposes of the application of the second paragraph of Article 110 to demonstrate that a given tax mechanism is likely, in view of its inherent characteristics, to bring about the protective effect referred to in that provision. In this regard, it is impossible to require in each case that the protective effect should be shown statistically.²⁰³¹

Any assessment of the compatibility of an internal tax with this prohibition must take account of the impact of that tax on the competitive relationship between the products concerned.

To determine the existence of a competitive relationship, it is necessary to consider:

- (i) The current state of the market;
- (ii) The possibilities for development within the context of the free movement of goods at EU level; and
- (iii) The further potential for the substitution of products for one another that may be revealed by the intensification of trade,

to fully develop the complementary features of the economies of the Member States in accordance with the objectives of the TFEU.²⁰³²

The essential question is whether a given tax is of such a kind as to have the effect, in the market in question, of reducing potential consumption of imported products to the advantage of competing domestic products.²⁰³³

Even if direct competition of any sort in relation to a domestic product is absent, protection will still be deemed to exist if imported products bear a fiscal charge in such a way that certain activities distinct from those used in the manufacture of the imported product are protected. In such a case, however, there must be a lasting economic relationship between the imported products and the protected activities and not merely a fortuitous relationship.²⁰³⁴ For example, the imposition by a Member State of a higher excise duty on wine imported in bottles to protect its domestic bottling industry is likely to fall within the prohibition against protective internal taxation.

4. Pursuit of Legitimate Objectives

The prohibitions set forth in Article 110 of the TFEU are not absolute. The CJEU recognizes that Member States may establish differing tax arrangements, even if this results in imported products being taxed more heavily than national products, provided such arrangements:

- (i) May be objectively justified on social, economic or industrial policy grounds; and
- (ii) Do not amount to fiscal discrimination or the protection of national production.²⁰³⁵

Therefore, at its current stage of development, EU law does not restrict the freedom of each Member State to establish tax arrangements that differentiate between certain products, even products that are similar within the meaning of the first paragraph of Article 110, based on objective criteria, such as the nature of the raw materials used or the production processes employed.

Such differentiation is compatible with EU law, however, only if:

- (i) It pursues economic policy objectives that are themselves compatible with the requirements of the TFEU and its secondary legislation; and
- (ii) The detailed rules are such as to avoid any form of discrimination, direct or indirect, with regard to imports from other Member States or any form of protection of competing domestic products.²⁰³⁶

In *Vinal*,²⁰³⁷ a case that concerned the different taxation of (imported) synthetic alcohol and (domestic) alcohol produced by fermentation in Italy, the CJEU accepted that the different tax treatment was justified since it was the result of an economic policy decision to;

- (i) Favor the manufacture of alcohol from agricultural products; and
- (ii) Inhibit the processing into alcohol of ethylene, a derivative of petroleum, to reserve that raw material for other more important economic uses.

Although the differential tax treatment resulted in discouraging imports of synthetic alcohol into Italy, it also had the consequence of hampering the development in Italy itself of production of alcohol from ethylene, such production being technically perfectly possible.

A different situation arises if the distinction criterion underlying the tax differentiation between imported and national products has no relevance for the latter product category. For example, a designation of origin or provenance, which by definition cannot be met by domestic products in the absence of rules protecting their designation of origin or provenance, could not serve as an objective criterion for the charging of higher taxation. As such, a system using such a criterion would have the effect of excluding domestic products in advance from

²⁰³⁰ Case 168/78, *Commission v. France*; Case 356/85, *Commission v. Belgium*.

²⁰³¹ Case 170/78, *Commission v. United Kingdom*.

²⁰³² Case 170/78, *Commission v. United Kingdom*.

²⁰³³ Joined Cases C-367/93 to C-377/93, *Rodgers*.

²⁰³⁴ Case 27/67, *Fink-Frucht*.

²⁰³⁵ See, e.g., Case 127/73, *Bobie*; Case 148/77, *H. Hansen*; Case 21/79, *Commission v. Italy*; Case 113/94, *Casarin*.

²⁰³⁶ This has been the consistent position taken in the case law of the CJEU ever since Case 196/85, *Commission v. France*.

²⁰³⁷ Case 46/80, *Vinal*.

heavier taxation since they would never fulfill the conditions on the basis of which the higher rate was charged.²⁰³⁸

5. “Sanctions”

Where a Member State is found to have violated the first paragraph of Article 110 of the TFEU, its duty is to equalize the taxes, not by equalizing upwards (i.e., raising the level of tax on the domestic product up to that imposed on the similar imported product), but by equalizing downwards (i.e., by reducing the tax on the imported product to the level imposed on the domestic product).²⁰³⁹

In contrast, where a Member State is found to have violated the second paragraph of Article 110 of the TFEU, its obligation is to remove the protective effect occasioned by the imposition of the higher tax imposed on the competing imported product.

This may mean, depending on the particular circumstances of each case, that:

- (i) The tax on the imported product is either reduced and thus made the same as that imposed on the competing domestic product; or
- (ii) The tax on the imported product is merely reduced somewhat so that the protective effect occasioned by the initial taxation level is negated.

In all instances, a tax that is incompatible with EU law must be repaid with interest.²⁰⁴⁰

6. Demarcation Issues — Charges Having Equivalent Effect Versus Internal Taxation

While Articles 30 and 110 of the TFEU complement each other in pursuing the objective of prohibiting any national fiscal measure capable of discriminating against products originating in, or destined for, other Member States by impeding their free movement within the European Union under normal conditions of competition, CJEU case law has maintained a formal distinction between the two prohibitions laid down by the TFEU:

- (i) Articles 30 and 110 may not be applied cumulatively or concurrently²⁰⁴¹ and, consequently,
- (ii) The legality of a national tax system that falls within the scope of Article 30 may not, at the same time, be assessed based on Article 110.²⁰⁴²

According to the case law, the distinction between charges having equivalent effect and internal taxes lies in the fact that the former affect only imported or exported products (with the

generating factor for such charges being “the crossing of a frontier,”) but not similar or competing national products, whereas the latter affect both categories of products.

According to the Court, a charge having equivalent effect is imposed specifically on an imported (or exported) product to the exclusion of a similar domestic product and has, by altering the price of the product, the same restrictive effect on the movement of products as a customs duty (see XIX.B.2., above).

In contrast, pecuniary charges under a general system of internal taxation that apply systematically to domestic and imported products according to the same criteria are covered by Article 110.²⁰⁴³

Nevertheless, for the purposes of categorizing and providing a legal assessment of charges imposed on domestic and imported products according to the same criteria, it may be necessary to take into account the purpose to which the revenue from the charges is put, because it is specifically in the light of that purpose that charges that are, formally speaking, neutral in terms of their structure and method of collection, may have a different real economic impact on the two categories of products.

Thus, if the revenue from a charge levied on both imported and domestic products is intended to finance activities for the special advantage of the taxed domestic product, the fiscal burden on the domestic product is, to a greater or lesser extent, neutralized by the advantages that the charge is used to finance, while the charge on the imported product constitutes a net burden.²⁰⁴⁴

In other words, it is necessary to determine whether that neutrality is lost in the light of the purpose for which the revenue is used. If, in fact, the charge on the domestic product is fully offset by the advantages that might accrue to that product as a result of the allocation of the revenue resulting from the application of the contested charge, it is Article 30 and not Article 110 of the TFEU that is applicable, because, appearances notwithstanding, the charge would in reality affect only the imported product.²⁰⁴⁵

Therefore, in determining whether a (para)fiscal charge is compatible with Articles 30 and 110 of the TFEU, it is necessary, according to (now) settled case law, to assess the extent to which the charge levied on the domestic product is offset by the advantages that the revenue from the charge is used to finance.

If the burden is fully offset, the charge in question constitutes a tax having equivalent effect, since it actually affects the imported product alone and will, therefore, have to be deemed to be entirely unlawful.

However, if the burden is offset in part only, the charge must be categorized as a discriminatory internal tax, since its

²⁰³⁸ Case 319/81, *Commission v. Italy*; see also Case 278/83, *Commission v. Italy*, concerning a product not produced in Italy that was put in a luxury class solely for taxation purposes.

²⁰³⁹ See, e.g., Joined Cases 2/62 and 3/62, *Commission v. Luxembourg and Belgium*.

²⁰⁴⁰ See Case C-565/11, *Irimi*; Case C-331/13, *Nicula*.

²⁰⁴¹ Case 10/65, *Deutschmann*; Case 57/65, *Lütticke*; Joined Cases C-78/90 to C-83/90, *Compagnie commerciale de l'Ouest and Others*.

²⁰⁴² In practically all of the cases in which the CJEU has been required to interpret those articles in relation to a specific national fiscal rule or to assess the legality of such a rule based on those articles, the CJEU has considered it necessary to decide whether the rule in question falls within the scope of the one article or the other. The CJEU adopted a less dichotomous approach in Case C-228/98, *Dounias*.

²⁰⁴³ See, *inter alia*, Case C-347/95, *UCAL*. This applies even if no similar domestically-produced products exist (Case 24/68, *Commission v. Italy*; Case C-47/88, *Commission v. Denmark*).

²⁰⁴⁴ See Case C-17/91, *Lornoy and Others*; Joined Cases C-78/90 to 83/90, *Compagnie commerciale de l'Ouest and Others*; Case C-72/92, *Sharbatke*; Case C-347/95, *UCAL*.

²⁰⁴⁵ See Case C-254/13, *Orgacom*.

impact is greater on the imported than on the domestic product, and it will, therefore, have to be reduced proportionately.²⁰⁴⁶

It is for the national court to make an assessment of that nature, since it alone has all of the evidence, including the matters of fact, required to make such an assessment.

For these purposes, the national court will have to:

- (i) Ascertain if the taxed product and the advantaged domestic product are the same;²⁰⁴⁷ and
- (ii) Check, during a reference period, on the financial equivalence of the total amounts levied on domestic products in connection with the charge and the advantages afforded exclusively to those products.

In that connection, the CJEU stated that any other parameter, such as the nature, scope or indispensable character of those advantages, would not provide a sufficiently objective basis on which to determine whether a domestic fiscal measure was compatible with the provisions of the Treaty.²⁰⁴⁸

It is worth reiterating that the prohibition of customs duties on imports and exports and charges having equivalent effect between Member States is absolute and, hence, there are no derogations or mandatory requirements that could justify proportionate violations or allow the taking of a measure outside the scope of the prohibition. As such, a charge that falls within the scope of Article 30 of the TFEU is illegal.

This is conceptually different from the scope of Article 110 of the TFEU, which (only) prohibits national measures that are discriminatory or protective in nature.

In addition, the charge-generating event is different (the crossing of frontiers under Article 30 affecting only imported or exported products versus a general system of internal taxation applying systematically to domestic and imported products according to the same criteria under Article 110).

Finally, the “sanctions” under Article 30 and Article 110 are different:

- (i) A charge falling within Article 30 is null, implying an obligation to make a full refund of the prohibited charge;²⁰⁴⁹
- (ii) A discriminatory measure under the first paragraph of Article 110 would (only) require a refund of the “excess” tax; and

(iii) A protective measure under the second paragraph of Article 110 would (only) consist in the removal of the protective effect.

7. Demarcation Issues — Free Movement of Goods Versus Internal Taxation

Articles 34 and 35 of the TFEU are aimed at the removal of quantitative restrictions on trade and all measures having equivalent effect, covering both imports and exports.

In relation to Article 34, Article 110 of the TFEU is considered to be *lex specialis*, meaning that cases covered by Article 110 exclude the application of Article 34.

This was addressed, for example, in *Kawala*,²⁰⁵⁰ in which the CJEU decided that, since a registration fee for imported secondhand vehicles was of a fiscal nature, it fell within the scope of Article 110 with the result that Article 34 did not apply to it. See also I.E.2., above.

D. Common Customs Tariff

As indicated above, next to the internal (intra-EU) aspect discussed in XIX.B. and XIX.C., above, the customs union aimed at in Article 28(1) of the TFEU also incorporates an external (EU-third countries) aspect, i.e., the adoption of a common customs tariff in the relations of the Member States with third countries.²⁰⁵¹

1. Common Customs Tariff and Customs Classification

The single customs territory of the European Union, as defined in Article 4 of the Uniform Customs Code (“UCC”),²⁰⁵² has one external customs frontier subject to the Common Customs Tariff (“CCT”).

The CCT applies to the import of goods across the external borders of the European Union. The tariff is common to all EU members, but the rates of duty differ from one kind of import to another, depending on what the import is and where it comes from. The rates depend on the economic sensitivity of products. More specifically, the tariff is the name given to the combination of the nomenclature (or classification of goods) and the duty rates applying to each class of goods. In addition, the tariff contains all other Community legislation that has an effect on the level of customs duty payable on a particular import, for example, country of origin. The tariff is a concept, a collection of laws as opposed to a single codified law in itself.

²⁰⁴⁶ See, e.g., Case C-206/06, *Essent Netwerk Noord and Others*, in which the CJEU held that a price surcharge imposed, without discrimination and subject to the same conditions, on the transmission of both national and imported electricity, constitutes a charge having equivalent effect to a customs duty prohibited by TFEU, Art. 30, where the revenue from that surcharge is intended to finance activities for the benefit of the domestic product alone and the resulting advantages offset in full the financial burden on that product; if the advantages offset the financial burden on that product in part only, then the surcharge constitutes discriminatory internal taxation, which is prohibited under TFEU, Art. 110.

²⁰⁴⁷ See Case 105/76, *Interzuccheri*; Case C-77/76, *Cucchi*.

²⁰⁴⁸ Case C-266/91, *CELB*.

²⁰⁴⁹ See, e.g., Case C-76/17, *Petrotel-Lukoil and Georgescu*, where the CJEU held that Article 30 of the TFEU must be interpreted as meaning that the taxpayer, who in fact pays the charge having an equivalent effect contrary to that article, must be able to obtain reimbursement of the sums which it has paid by way of that charge, even in a situation where the payment mechanism for the charge has been designed in national legislation so that the charge is passed on to the consumer.

²⁰⁵⁰ Case C-134/07, *Kawala*.

²⁰⁵¹ A comprehensive discussion of EU customs law is out-of-scope of this Portfolio as, in the author’s opinion, customs duties have evolved into forming an integral part of international trade law rather than tax law.

²⁰⁵² Regulation (EU) No 952/2013 of the European Parliament and of the Council of October 9, 2013 laying down the Union Customs Code. The objective scope of the UCC does not extend to trade in services or capital but only to “trade between the Community and third countries,” implying international trade in “goods.” (UCC, Art. 1), whereby the term “goods” (not further defined in either the TFEU or the UCC) refers to, generally speaking, all movables that are of value and can form the subject of international transactions are regarded as goods (see Case 7/68, *Commission v. Italy*, where the CJEU defined “goods” as products that can be valued in money and that are capable, as such, of forming the subject of commercial transactions). For example, waste, whether recyclable and reusable or not, is to be regarded as “goods” (Case C-2/90, *Commission v. Belgium*). Gas and electricity can also form the subject of transactions (see Case C-158/94, *Commission v. Italian Republic*).

The CCT is, itself, preceded by General Rules. There are also Explanatory Notes to the CCT. While the General Rules of the CCT are binding on EU Member States, the Explanatory Notes (of the World Customs Organization (WCO)) to the Brussels Nomenclature and the WCO's Classification Opinions²⁰⁵³ are authoritative (but not binding) in interpreting the CCT. The final word on the interpretation of the CCT lies with the EU institutions, subject to review by the CJEU.²⁰⁵⁴

Until January 1, 1988, two different coding systems were in place:

- (i) The CCT; and
- (ii) A system for use in statistical measures of trade between Member States (NIMEXE).

The Union's external tariff covered:

- (i) The standard CCT duty rates (whether "autonomous" or "conventional")²⁰⁵⁵ applicable to imports from third countries;

- (ii) An extensive range of specific measures, such as:

- Tariff suspensions for industrial products;
- Autonomous or conventional tariff quotas;
- Generalized tariff preferences;
- Special tariff preferences for the Mediterranean countries etc.; and

- (iii) Nontariff measures such as surveillance and quantitative ceilings managed based on either the CCT or the statistical nomenclatures.

A single instrument with one coding system was therefore required. The introduction of the Combined Nomenclature (CN)²⁰⁵⁶ and the *Tarif Intégré Communautaire* (TARIC), the Union's integrated tariff, which is, in turn, based on the CN, provided the required solution.

The CN is based on the Harmonized System (HS),²⁰⁵⁷ which:

- (i) Is based on the Brussels Nomenclature of the WCO; and
- (ii) Additionally, draws on other nomenclatures used in international trade to constitute a modern and comprehensive worldwide nomenclature.

²⁰⁵³ These are case-by-case Opinions delivered at the request of one or another Member State.

²⁰⁵⁴ See, e.g., Case C-182/19, *Pfizer Consumer Healthcare*; Case C-677/18, *Amoena*; Case C-545/16, *Kubota (UK) and EP Barrus*; Joined Cases C-435/15 and C-666/15, *GROFA and Others*.

²⁰⁵⁵ "Autonomous" rates apply in cases where there are no preferential ("conventional") rates. Sometimes the rates are the same, but autonomous rates are usually higher.

²⁰⁵⁶ Council Regulation (EEC) No 2658/87 of July 23, 1987, as last amended by Commission Implementing Regulation (EU) September 26, 2023 amending Annex I to Council Regulation (EEC) No 2658/87 on the tariff and statistical nomenclature and on the Common Customs Tariff (applicable as of January 1, 2024).

²⁰⁵⁷ Work on the Harmonized System (HS), involving approximately 60 countries and more than 20 international organizations, began in 1973 and was concluded in June 1983. The International Convention on the Harmonized Commodity Description and Coding System was ratified by the EC on September 22, 1987, and entered into force on January 1, 1988, for the EC and its major trading partners, including Canada and the United States.

The HS is:

- (i) A harmonized commodity description and coding system;

- (ii) A six-digit coding for the identification and classification of imported and exported goods, for the purposes of compiling trade statistics and determining customs tariff. It divides goods into approx. 5,000 groups and sub-groups.

The CN is comprised of:

- (i) The HS nomenclature;

- (ii) EC subdivisions/headings with respect to that nomenclature (where a corresponding duty rate is specified); and

- (iii) Preliminary provisions, additional sections or chapter notes and footnotes relating to subheadings.

The preliminary provisions contain, *inter alia*, general rules for the interpretation of the CN.

The CN has eight-digit codes:

- (i) The first six digits represent the HS codes (as required by the HS Convention); and

- (ii) The last two digits identify the CN subheadings.

Additionally, there may be a ninth digit reserved for the use of national statistical subdivisions and a 10th and 11th digit for the TARIC.

Like the HS, the CN consists of 21 sections, covering 99 chapters. Some sections and chapters of the CN are preceded by notes. Member States base their integrated tariff/statistical instruments on TARIC. They may also add further subdivisions to the TARIC, coded in the 12th and 13th digits, to cover certain national measures such as VAT and excise duties.

Under the UCC, import and export duty due is based on the CCT. Other measures prescribed by the European Union provisions governing specific fields relating to trade in goods are, where appropriate, to be applied in accordance with the tariff classification of those goods.²⁰⁵⁸

For these purposes, the CCT comprises:

- (i) The CN;

- (ii) Any other nomenclature:

- Wholly or partly based on the CN or providing for further subdivisions of the CN; and

- Provisions established by the European Union governing specific fields with a view to the application of tariff measures relating to trade in goods;

- (iii) The conventional or normal autonomous customs duty applicable to goods covered by the CN;

- (iv) The preferential tariff measures contained in agreements that the European Union has concluded with certain countries or territories outside the customs territory of the European Union or groups of such countries or territories;

- (v) Preferential tariff measures adopted unilaterally by the European Union with respect to certain countries or territories outside the customs territory of the European Union or groups of such countries or territories;

²⁰⁵⁸ UCC Regulation, Art. 56(1).

(vi) Autonomous measures providing for a reduction in, or exemption from, customs duty on certain goods;

(vii) Favorable tariff treatment specified for certain goods, by reason of their nature or end-use, within the framework of measures referred to in (iii) to (vi) or (viii); and

(viii) Other tariff measures provided for by agricultural or commercial or other European Union²⁰⁵⁹

For the application of the CCT, the tariff classification of goods consists in the determination of one of the subheadings or further subdivisions of the CN under which those goods are to be classified.²⁰⁶⁰

For the application of non-tariff measures, the tariff classification of goods consists in the determination of:

(i) One of the subheadings or further subdivisions of the CN; or

(ii) Any other nomenclature established by the provisions of the European Union that is wholly or partly based on the CN or that provides for further subdivisions of the CN, under which those goods are to be²⁰⁶¹

As noted above, the classification of goods in the CN is governed by six interpretative principles or “rules.” These are (currently) set out in Part One, Section I, A. of Annex 1 to the Commission Implementing Regulation (EU) No 2023/2364 of September 26, 2023.²⁰⁶²

• Rule 1: “The titles of sections, chapters and sub-chapters are provided for ease of reference only; for legal purposes, classification shall be determined according to the terms of the headings and any relative section or chapter notes and, provided such headings or notes do not otherwise require, according to the following provisions [i.e., Rules 2 to 6].”

This is the first Rule to be considered in classifying any product. Most products are classified according to Rule 1, which, for practical purposes, may be broken down into two parts:

(i) The words in the section and chapter titles are to be used as guidelines only to point the way to the area of the Tariff in which the product to be classified is likely to be found. Articles may be included in or excluded from a section or chapter even though the titles might lead one to believe otherwise; and

(ii) Classification is determined by the words (terms) in the headings (the first four numbers) and the section and chapter notes that apply to them unless the terms of the heading and the notes specify otherwise.²⁰⁶³

As such, if the goods to be classified are covered by the words in a heading and the section and chapter notes do not exclude classification in that heading, the heading applies. If the results of this process are ambiguous and two

or more headings appear to be applicable, Rule 3 should be applied. Rule 1 takes precedence over Rules 2–5.²⁰⁶⁴

• Rule 2(a): “Any reference in a heading to an article must be taken to include a reference to that article incomplete or unfinished, provided that, as presented, the incomplete or unfinished article has the essential character of the complete or finished article. It shall also be taken to include a reference to that article complete or finished (or falling to be classified as complete or finished by virtue of this rule), presented unassembled or disassembled.”

Rule 2(a) deals with the classification of unfinished, incomplete, unassembled or disassembled goods. Unfinished and incomplete goods can be classified under the same heading as the same goods in a finished state provided they have the essential character of the complete or finished goods. Similarly, unassembled or disassembled goods may in such circumstances also be classified under the same heading as the complete or finished products.²⁰⁶⁵ This rule does not apply if the text of the heading or the relevant legal notes exclude the unfinished or unassembled products in question.²⁰⁶⁶

• Rule 2(b): “Any reference in a heading to a material or substance shall be taken to include a reference to mixtures or combinations of that material or substance with other materials or substances. Any reference to goods of a given material or substance shall be taken to include a reference to goods consisting wholly or partly of such material or substance. The classification of goods consisting of more than one material or substance shall be according to the principles of rule 3.” Rule 2(b) concerns goods not classifiable through the use of Rule 1 or Rule 2(a) that are composed of a mixture of materials or substances. Broadly, a heading referring to a given material or substance includes mixtures of that substance with other materials/substances. Similarly, a reference to a product composed of a given material or substance includes products composed either wholly or partly of that material or substance. This means that a mixed product may seem to be eligible for classification under two or more headings. However, a given product can legally only be classified under one heading. Rule 3 must be used to decide between alternate headings.²⁰⁶⁷

²⁰⁶⁴ Joined Cases C-362/07 and C-363/07, *Kip Europe and Others (C-362/07) and Hewlett Packard International (C-363/07)*; see also Case 137/78, *Henningsen Food and others v Produktschap voor Pluimvee en Eieren*.

²⁰⁶⁵ See, e.g., Case C-16/08, *Schenker*, concerning the tariff classification of certain active matrix liquid crystal devices. See also Joined Cases C-208/06 and C-209/06, *Medion (C-208/06) and Canon Deutschland (C-209/06)* (tariff classification of camcorders); Case C-280/97, *ROSE Elektrotechnik GmbH & Co. KG v. Oberfinanzdirektion Köln* (tariff classification of incomplete junction boxes); Case C-295/81, *IFF* (tariff classification of fruit-juice concentrates and flavor concentrates); Case C-290/97, *Bruner v. Hauptzollamt Hamburg-Jonas* (classification of poultry cuts); Case C-401/93, *GoldStar Europe v. Hauptzollamt Ludwigshafen* (classification of incomplete video recorders).

²⁰⁶⁶ See, e.g., Case C-2/13, *Humeau Beaupréau*: an upper, an outer and an inner sole, as an article presented unassembled having the essential character of footwear, come under heading 6404 of the combined nomenclature (textile uppers with rubber/plastic soles) where, following their import, a counter must be inserted into the upper and the outer sole and the upper must be roughed for purposes of assembly.

²⁰⁶⁷ On the interaction between Rule 2(b) and Rule 3, see, e.g., Case C-234/81, *Du Pont de Nemours* (classification of “corian,” a building material made

²⁰⁵⁹ UCC Regulation, Art. 56(2).

²⁰⁶⁰ UCC Regulation, Art. 57(1).

²⁰⁶¹ UCC Regulation, Art. 57(2).

²⁰⁶² Commission Implementing Regulation (EU) 2023/2364 of September 26, 2023 amending Annex I to Council Regulation (EEC) No 2658/87 on the tariff and statistical nomenclature and on the Common Customs Tariff.

²⁰⁶³ See, e.g., Case C-130/82, *Farr*.

• Rule 3: When, by application of Rule 2(b) or for any other reason, goods are *prima facie* classifiable under two or more headings, classification is to be made as follows.²⁰⁶⁸

• Rule 3(a): “The heading which provides the most specific description shall be preferred to headings providing a more general description. However, when two or more headings each refer to part only of the materials or substances contained in mixed or composite goods or to part only of the items in a set put up for retail sale, those headings are to be regarded as equally specific in relation to those goods, even if one of them gives a more complete or precise description of the goods.”

Rule 3(a) states that where two or more headings seem to apply, the one that provides the most specific description of the product in question should be used. This means that a heading that names the actual product should be used in preference to one that only names a category to which the product could belong. Similarly, a heading that describes the whole product should be used in preference to one that describes part of it. However, where two headings both only describe part of the product, this rule cannot be used to tell which one to use even if one seems more specific or detailed than the other.

• Rule 3(b): “Mixtures, composite goods consisting of different materials or made up of different components, and goods put up in sets for retail sale, which cannot be classified by reference to 3(a), shall be classified as if they consisted of the material or component which gives them their essential character,²⁰⁶⁹ in so far as this criterion is applicable.”

Rule 3(b) applies to mixtures and composite goods and provides that they cannot be classified by using the previous Rules. These should be classified as if they consisted of the material or component that gives them their essential character. Rule 3(b) was at the heart of the famous (and contentious) ink cartridge cases.²⁰⁷⁰

to look like marble) and Case C-286/15, *Latvijas propāna gaze* (Rules 2(b) and 3(b) must be interpreted as meaning that, where the essential character of a gas mixture, such as the liquefied petroleum gas at issue in the main proceedings, is determined by all the components of that mixture together, so that no component may be identified as the factor giving it its essential character and, in any event, the exact quantity of each of the components of the liquefied petroleum gas at issue may not be determined, a presumption that the factor that gives the goods their essential character, within the meaning of Rule 3(b) of those general rules, is the substance that is present in the greatest proportion in the mixture must not be used).

²⁰⁶⁸ Rules 3(a), (b) and (c) are to operate in order of appearance (Case 28/75, *Baupla GmbH v. Oberfinanzdirektion Köln*).

²⁰⁶⁹ To establish “essential character,” it is necessary to identify, from among the materials of which goods are composed, the material that gives the goods their essential character; this may be done by determining whether the goods would retain their characteristic properties if one or other of their constituents were removed from them (see, e.g., Case C-253/87, *Sportex*; Case C-288/99 *VauDe Sport*).

²⁰⁷⁰ In Case C-276/00, *Turbon International*, the CJEU concluded that ink-cartridges designed for a specific type of ink-jet printer (*in casu*, the Epson Stylus Color) were to be classified as ink under CN subheading 3215 90 80. It based this *inter alia* on the assumption that the mechanical and electronic functioning of the printer in itself was not dependent on the presence of an ink-cartridge. Almost five years later, despite the dissenting Opinion of Advocate General Kokott, the CJEU restated (again with respect to the Epson Stylus Col-

• Rule 3(c): “When goods cannot be classified by reference to 3(a) or (b), they shall be classified under the heading which occurs last in numerical order among those which equally merit consideration.”

Rule 3(c) should be used in cases in which goods seem to fit in more than one heading and their essential character cannot be determined. In this case, the product should be classified under the heading that occurs last in numerical order. This is effectively the “tie-breaker” rule.

• Rule 4: “Goods which cannot be classified in accordance with the above rules shall be classified under the heading appropriate to the goods to which they are most akin.”

This is a “last resort” rule, most frequently used in relation to new products.

• Rule 5. In addition to the foregoing provisions, the following rules apply with respect to the goods referred to therein:

• Rule 5(a): “Camera cases, musical instrument cases, gun cases, drawing-instrument cases, necklace cases and similar containers, specially shaped or fitted to contain a specific article or set of articles, suitable for long-term use and presented with the articles for which they are intended, shall be classified with such articles when of a kind normally sold therewith. This rule does not, however, apply to containers which give the whole its essential character.”

Rule 5(a) deals with containers that are shaped or fitted for the articles they contain, are suitable for long-term use, protect the articles when not in use, are of a kind normally sold with such articles, and are presented with the articles they are designed to contain. A container that has these characteristics can be classified based on the products it contains. However, where a container gives the product its essential character, it would be the container that would have to be classified.

• Rule 5(b): “Subject to the provisions of rule 5(a), packing materials and packing containers presented with the goods therein shall be classified with the goods if they are of a kind normally used for packing such goods. However, this provision is not binding when such packing materials or packing containers are clearly suitable for repetitive use.”

Rule 5(b) deals with other types of containers and packing materials. Specifically, the terms “packing materials” and “packing containers” mean any external or internal containers, holders, wrappings or supports other than transport devices (for example, transport containers), tarpaulins, tackle or ancillary transport equipment, where the term “packing containers” does not cover the containers referred to in general Rule 5(a). These should be classified

or) that, even if an ink cartridge is constructed in such a way that the printer does not function in the absence of that cartridge, the fact remains that the ink contained in the cartridge is the most important factor for purposes of using the goods at issue. In fact, the ink cartridge is not inserted in the printer to make the printer itself function but specifically to supply it with ink. Therefore, the ink must be regarded as determining the essential character of an ink cartridge and, hence, the ink cartridge should be classified as “ink” (Case C-250/05, *Turbon International*).

with the goods they contain if they are of a kind normally used for packing such goods and are not suitable for repetitive use.

• Rule 6: “For legal purposes, the classification of goods in the subheadings of a heading shall be determined according to the terms of those subheadings and any related subheading notes and, *mutatis mutandis*, to the above rules, on the understanding that only subheadings at the same level are comparable. For the purposes of this rule, the relative section and chapter notes also apply, unless the context requires otherwise.”

Once goods have been classified to the heading level by the use of Rules 1 to 5, classification to the subheading level can now take place by repeating Rules 1 to 5 and taking into account any related legal notes. Customs classification is hierarchical in the sense that goods are classified at four-digit level, then six and so on until the full 10-digit code is obtained. Alternative classifications should only be compared at the same level, i.e., a six-digit code should be compared against a six-digit code and not against an eight-digit code.

As early as in *Hauptzollamt Bielefeld v. Offene Handelsgesellschaft in Firma HC König*,²⁰⁷¹ the CJEU emphasized that the decisive criteria for the classification of products in the CCT were their:

- (i) Characteristics; and
- (ii) Objective properties,

i.e., in the interests of legal certainty and ease of verification, the decisive criteria for the classification of goods for customs purposes were in general to be found in their objective characteristics and properties as defined in the wording of the relevant heading of the CN and of the Explanatory Notes to the sections or chapters.²⁰⁷²

The CJEU further held that the Explanatory Notes drawn up, as regards the CN, by the Commission and, as regards the HS, by the WCO, might be an important aid to the interpreta-

tion of the scope of the various headings. However, such notes did not have legally binding force.²⁰⁷³

Finally, according to CJEU, the intended use of a product might constitute an objective criterion for classification if it is intrinsic to the product and that intrinsic character was capable of being assessed based on the product's objective characteristics and properties. In other words, one must look at the objectively determined intended use when considering a product's objective characteristics.²⁰⁷⁴

2. Free Trade Agreements and Generalized System of Preferences

By making use of applicable free trade agreements (FTAs), a trader can benefit from preferential duty rates (reduced or zero) when importing eligible products. An FTA is a bilateral or multilateral agreement, where each participating country gives preferential treatment to imports of the other's products.

In addition to FTAs, there is also the Generalized System of Preference (GSP), which applies unilaterally. The purpose of the GSP is to give developing countries easier market access to the EU by granting them zero/reduced rates of import duty. The benefits of the GSP scheme are granted at the sole discretion of the destination country. To be eligible for preferential duty treatment under the GSP scheme or an FTA, goods have to fulfil a set of conditions applicable to the production and the distribution stages.

²⁰⁷¹ Case 185/73, *Hauptzollamt Bielefeld v. Offene Handelsgesellschaft in Firma HC König*.

²⁰⁷² See, *inter alia*, Case C-396/02, *DFDS*; Case C-495/03, *Intermodal Transports*; Case C-445/04, *Possehl Erzkontor*; Case C-15/05, *Kawasaki Motors Europe*; Case C-310/06, *FTS International* and Case C-486/06, *Van Landeghem*. The qualification “in general” would seem to translate acceptance of the fact that all tariff classifications are not necessarily open to objective assessment. Within the CCT, goods are to be classified based on their objective characteristics and properties as these exist when customs clearance is obtained (Case 38/76, *Industriemetal Luma GmbH v Hauptzollamt Duisburg*).

²⁰⁷³ In Case C-35/93, *Develop Dr Eisbein GmbH & Co v. Hauptzollamt Stuttgart-West*, the CJEU held that the Harmonized System Explanatory Notes (HSEs) can be used for persuasive but non-legally binding guidance. In Case C-495/03, *Intermodal Transport*, the European Court of Justice (ECJ) recognized that the Explanatory Notes to the CN published by the EU Customs Code Committee (CNENs) and the HSEs are an important aid to the interpretation of the scope of the various tariff headings, albeit that they do not have legally binding force; thus, the content of these notes will be ignored if it is incompatible with the provisions of the CN or if it alters the meaning of these provisions. The CJEU in Case C-142/06, *Olicom*, noted that the CNENs are an important means of ensuring the uniform application of the Tariff and as such are to be regarded as useful aids to interpretation. In cases where CNENs or HSEs are not incompatible with the terms of the CN, a national court should follow them (Case C-400/05, *BAS Trucks BV v. Staatssecretaris van Financiën*). Where explanatory notes are attached to the Tariff itself, they constitute an important factor in interpreting the Tariff, enabling the headings or subheadings to be defined or clarified (Case 54/79, *Firma Hako-Schuh Dietrich Bahner v. Hauptzollamt Frankfurt Am Main-Ost*).

²⁰⁷⁴ See, e.g., Case C-366/22, *Vitera Hungary*; Case C-182/19, *Pfizer Consumer Healthcare*; Case C-153/10, *Sony Supply Chain Solutions (Europe)*; see also Case C-459/93, *Thyssen Haniel Logistic*.

XX. Emissions Trading Scheme — Carbon Border Adjustment Mechanism

A. General

Executive Summary

This Section discusses the carbon border adjustment mechanism (CBAM), which is essentially the third country mirroring of the intra-EU emissions trading system (EU ETS).

Following its formal adoption by the European Parliament on April 18, 2023, the Council adopted Regulation (EU) 2023/956 establishing a carbon border adjustment mechanism on April 25, 2023. This regulation was subsequently signed by the EU co-legislators on May 10, 2023 (the “CBAM Regulation”).²⁰⁷⁵

The CBAM Regulation entered into force the day after its publication in the EU Official Journal, i.e., on May 17, 2023. It should be:

(i) Seen in the light of the Commission’s “Fit for 55 Package” under the European Green Deal (with a target of reducing EU emissions by at least 55% by 2030, relative to its 1990 levels, to achieve a climate-neutral (net zero) Europe by 2050), as announced in Commission Communication “Business Taxation for the 21st Century” of May 18, 2021;²⁰⁷⁶ and

(ii) Read in conjunction with Commission Implementing Regulation (EU) 2023/1773 of August 17, 2023, laying down reporting obligations for the purposes of the CBAM during the transitional period (the “CBAM Implementing Regulation.”)²⁰⁷⁷

The CBAM Regulation is, in essence, the third-country mirroring face of the (intra-Union) EU Emissions Trading System (EU ETS) that was set up in 2005 and is currently in its fourth phase (2021–2030).

B. The EU ETS Scheme: Overview

The EU ETS is a cap-and-trade mechanism that assists the EU in reaching its emissions reduction objectives by creating a market, and therefore a price, for carbon emissions.

The EU ETS applies in all EU Member States, the European Free Trade Association countries (Iceland, Liechtenstein and Norway) as well as Northern Ireland for electricity generation.

It covers the following greenhouse gases from specific activities, focusing on emissions that can be measured, reported and verified with a high level of accuracy:

²⁰⁷⁵ Regulation (EU) 2023/956 of the European Parliament and of the Council of May 10, 2023 establishing a carbon border adjustment mechanism, *OJ L 130*, 16.5.2023, p. 52–104. The CBAM Regulation entered into force the day after its publication in the EU Official Journal, i.e., on May 17, 2023.

²⁰⁷⁶ COM (2021) 251 final.

²⁰⁷⁷ Commission Implementing Regulation (EU) 2023/1773 of August 17, 2023 laying down the rules for the application of Regulation (EU) 2023/956 of the European Parliament and of the Council as regards reporting obligations for the purposes of the carbon border adjustment mechanism during the transitional period.

(i) Carbon dioxide (CO₂) from:

(a) Electricity and heat generation;

(b) Energy-intensive industry sectors (including oil refineries and steel works);

(c) Production of iron, aluminum, metals, cement, lime, glass, ceramics, pulp, paper, cardboard, acids and bulk organic chemicals;

(d) Aviation within the EEA and departing flights to Switzerland and the United Kingdom;

(e) Maritime transport, specifically 50% of emissions from voyages starting or ending outside of the EU and 100% of emissions from voyages between two EU ports and when ships are within EU ports;

(ii) Nitrous oxide (N₂O) from production of:

(a) Nitric acid;

(b) Adipic acid;

(c) Glyoxylic acids; and

(d) Glyoxal; and

(iii) Perfluorocarbons (PFCs) from the production of aluminum.

Participation in the EU ETS is mandatory for companies in these sectors.

However, in certain sectors, only operators above a certain size are included. In addition, a number of small installations may be excluded if governments introduce alternative measures to cut their emissions.

Under the EU ETS scheme, companies must buy or receive allowances, i.e., the European Emission Allowances (EUAs), corresponding to their CO₂ emissions.

EUAs make power production from burning coal and other fossil fuels more expensive, and clean power sources comparably more attractive.

The EU ETS follows a “cap and trade” approach, i.e., the EU sets a cap on how much CO₂ can be emitted — which decreases each year (the Linear Reduction Factor or LRF)²⁰⁷⁸ — and companies must have an EUA for every tonne of CO₂ they emit within one calendar year. They receive or buy these EUAs and they can trade them. After each year, they surrender enough allowances to cover their full emissions.

Free EUAs are allocated to qualifying manufacturing industries facing competition from industries outside the EU that are not subject to comparable climate legislation. This allocation, as from phase 3 (2013–2020) onwards, is based on benchmarks that reward the most efficient installations in each sector.

As of 2026 (i.e., when the CBAM comes into effect for a number of sectors, see below), free EUA are to decrease from year to year and are expected to phase out completely in 2034.

²⁰⁷⁸ As of 2013, the Linear Reduction Factor (LRF) was set at 1.74 percent, increased to 2.2% from 2021 and currently set at 4.3 percent from 2024 to 2027 and 4.4 percent from 2028 to 2030.

C. CBAM

1. Overview

The CBAM²⁰⁷⁹ seeks to address the risk of carbon leakage alongside the evolution of the EU ETS by ensuring equivalent carbon pricing for imports and domestic products.

“Carbon leakage” is when:

- (i) Production is transferred from the EU to other countries that have lower climate change standards; or
- (ii) EU products are replaced by more carbon-intensive imports.

In essence, the CBAM is intended to ensure that the price of imports more accurately reflects their carbon content.

The CBAM does not apply to goods originating in Iceland, Liechtenstein and Norway, which belong to the EU ETS and Switzerland (which has an ETS linked to the EU ETS). Nor does it apply to goods originating in the following territories:

- (i) Büsingen;
- (ii) Heligoland;
- (iii) Livigno;
- (iv) Ceuta; and
- (v) Melilla.

There is also a (conditional) exemption for the importation of electricity from a third country or third territory that:

- (i) Has an electricity market integrated with the Union internal market for electricity through market coupling; and
- (ii) There is no technical solution for the application of the CBAM to the importation of electricity into the customs territory of the Union from that third country or territory.

The CBAM covers a wide range of goods originating in a third country, namely:

- (i) Iron and steel products;
- (ii) Cement and cement products;
- (iii) Mineral and chemical fertilizers;
- (iv) Aluminum products;
- (v) Electricity, and hydrogen, as well as certain precursors and downstream products (see Annex I of the CBAM Regulation for the concerned CN codes).

Moreover, the CBAM also covers indirect emissions (carbon emissions linked to the consumption of fossil electricity) under certain conditions. In this context, the Commission is mandated to adopt implementing acts to further specify the scope of the CBAM and could thus decide to broaden its scope to include products further down the value chain. Reportedly, it is envisaged that, by 2030, the list of CBAM products will be extended to cover all products already subject to the EU ETS (see above).

The CBAM, an EU policy mechanism that blends features of both tax and customs duties, is being introduced as a two-stage process.

(i) First, from October 1, 2023 and for the duration of the transitional period (which ends on December 31, 2025), the CBAM regulation only provides for reporting obligations. Importers of CBAM goods or their indirect customs representatives are required to submit a quarterly report, to be verified by the Commission, detailing:

- (a) The total quantity of each type of CBAM goods imported during the quarter;
- (b) The CO₂ emissions embedded in those goods; and
- (c) Any costs incurred in the country of origin in relation to those emissions, i.e., any carbon price paid in the country of origin.

Incomplete or inaccurate declarations may be sanctioned by the competent Member State authority. The transitional period is intended to:

- (a) Facilitate the rollout of the system; and
- (b) Reduce disruptions to trade.

(ii) Second, upon expiry of the transitional period, when the system is expected to be fully implemented, the CBAM Regulation will become fully operational, imposing obligations to:

- (a) Purchase CBAM certificates (in essence, designed as a border tax); and
- (b) Meet administrative requirements, including new reporting obligations.

The definitive operational phase of the CBAM started on January 1, 2026. As from that date, importing CBAM goods into the EU require “authorized CBAM declarant” status. Customs authorities will no longer allow the importation of goods by any person other than an authorized CBAM declarant.

To obtain “authorized CBAM declarant” status, the importer or his/her indirect customs representative (if the importer is not established in a Member State and the indirect customs representative agrees to act as an authorized CBAM declarant) must submit, prior to the importation of goods into the customs territory of the Union, an application for authorization with the relevant Member State’s competent authority. The competent authority will have 15 days to carry out the necessary checks and, if the conditions for authorization set out by the CBAM Regulation are met, must include the importer (or, as the case may be, the importer’s indirect customs representative) in the CBAM register (i.e., the registry of authorized CBAM declarants to be established by the Commission in the form of a standardized electronic database containing the data regarding the CBAM certificates of the authorized CBAM declarants).

By May 31 of each year, and for the first time in 2027 for the year 2026, authorized CBAM declarants are required to submit, via the CBAM registry, a CBAM declaration for the preceding calendar year, containing the following information:

- (i) The total quantity of each type of goods imported during the preceding calendar year, expressed in megawatt-hours for electricity and in tonnes for other goods;

²⁰⁷⁹ Regulation (EU) 2023/956 of the European Parliament and of the Council of May 10, 2023 establishing a carbon border adjustment mechanism.

(ii) The total embedded emissions in those goods, expressed in tonnes of CO₂ emissions per megawatt-hour of electricity or, for other goods, in tonnes of CO₂ emissions per tonne of each type of goods;

(iii) The total number of CBAM certificates to be surrendered, corresponding to the total embedded emissions referred to in (ii), after the reduction due on the account of the carbon price paid in a country of origin and the adjustment necessary to reflect the extent to which EU ETS allowances are allocated free of charge; and

(iv) Copies of verification reports, issued by accredited verifiers.

For the purposes of (ii), calculations of embedded emissions must be performed pursuant to the methods referred to in Article 7 of the CBAM Regulation. The authorized CBAM declarant is to keep records of the information required to calculate the embedded emissions until the end of the fourth year following the year in which the CBAM declaration has been or should have been submitted.

As regards (iii), in a system that replicates the EU ETS scheme, authorized CBAM declarants will be required to purchase CBAM certificates, sold through a platform set up by the Commission, required to offset the emissions embedded in imported CBAM goods in the previous year.

Each CBAM certificate (corresponding to one tonne of CO₂ emitted into the atmosphere) will be purchasable at the average weekly ETS allowance's cost. Authorized CBAM declarants are to ensure quarterly that the number of CBAM certificates held (and visible on their "CBAM account") is sufficient to cover at least 80% of the emissions embedded in the imported CBAM goods. They will have to surrender, by May 31 of each year, CBAM certificates corresponding to the amount of CO₂ emissions embedded in CBAM goods imported during the relevant calendar year (it being understood that they will be entitled to claim in their CBAM declaration a reduction in the number of CBAM certificates to be surrendered to take account of the carbon price effectively paid (and after deduction of any rebate or compensation available) in the country of origin for the declared embedded emissions ("credit system."))

CBAM certificates are not tradeable or bankable, but companies may sell a limited quantity of unused certificates back to a national authority.

Effective as of October 20, 2025,²⁰⁸⁰ a *de minimis* exemption from the CBAM obligations applies to importers, including any importer with the status of an authorized CBAM declarant, where the net mass of the imported goods in a given calendar year does not cumulatively exceed a "single mass-based threshold", initially set at a level of 50 tons (which level is to be monitored by the Commission by April 30 of each calendar year to make sure that the threshold applies to no more than 1% of the emissions embedded in the imported goods and processed products). The single mass-based threshold replaces the formerly applicable 150 euros threshold that was found to be insufficient to ensure that the CBAM applies to importers

in proportion to the impact of those importers on the emissions covered by the CBAM. The single mass-based threshold applies to the total net mass of goods under all CN codes aggregated per importer and per calendar year, but it does not apply to imports of electricity or hydrogen. To mitigate the risk of manipulation, specific rules apply to monitor and penalize attempts to bypass registration or the purchase of CBAM certificates. Also, effective as of October 20, 2025, a set of simplifications applies for importers of CBAM goods above the threshold to facilitate their compliance with the reporting requirements. In particular, applicable rules simplify and streamline the authorization procedure for national competent authorities and the Commission, the data collection processes from third country producers to authorized CBAM declarants, the calculation of embedded emissions for certain goods, the emission verification rules, the calculation of the authorized CBAM declarants' financial liability during the year of imports into the EU and the claim by authorized CBAM declarants for carbon prices paid in third countries where goods are produced.

Comment: In the Explanatory Memorandum of its 2021 Proposal for a Regulation establishing a CBAM (which ultimately became the CBAM Regulation), the Commission expressed its confidence that the (proposed) mechanism was "WTO compatible."

However, it remains uncertain whether:

(i) A carbon border adjustment (such as the one introduced under the CBAM) would comply with the WTO rules because a WTO dispute settlement panel has never considered the issue;

(ii) A carbon border adjustment would be consistent with key GATT principles, such as nondiscrimination obligations; and

(iii) Specific GATT exceptions, such as those for national security and the protection of human, animal, or plant life or health (Article XX(b) of the GATT) might allow a carbon border adjustment that is otherwise deemed inconsistent with key GATT principles.²⁰⁸¹

The question remains as to whether the CBAM, in its current substantive form and in particular in its second stage, should be considered fully WTO compatible.

2. Future Prospects

On December 17, 2025, the Commission launched proposals for regulations²⁰⁸² aimed at:

- An extension of the CBAM scope to include specific steel and aluminum-intensive downstream products (starting in January 2028). The proposal covers 180 additional product categories including car parts, domestic appliances (e.g. refrigerators, washing machines), construction

²⁰⁸⁰ Regulation (EU) 2025/2083 of the European Parliament and of the Council of October 8, 2025 amending Regulation (EU) 2023/956 as regards simplifying and strengthening the carbon border adjustment mechanism.

²⁰⁸¹ Ramseur, J.L., Murrill, B.J. and Casey, C.A., Congressional Research Services, Border Carbon Adjustments: Background and Developments in the European Union, Update February 21, 2023.

²⁰⁸² Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) 2023/956 as regards the extension of its scope to downstream goods and anti-circumvention measures, COM/2025/989 final, 2025/0419(COD) and Proposal for a Regulation of the European Parliament and of the Council establishing the Temporary Decarbonization Fund, COM/2025/990 final, 2025/0418(COD).

products, power transformers, cables, farming machinery and a wide range of industrial equipment. Goods containing steel or aluminum as functional components would also be in scope, such as fasteners, fittings, furniture components, and electrical cables. The expansion is expected to bring an additional 7,500 importers into compliance scope.

- Introduction of additional anti-circumvention measures. Key proposals include enhanced reporting requirements for better traceability of CBAM goods and addressing emission intensity misdeclarations.

- Establishment of a Temporary Decarbonization Fund (“TDF”), valued at up to €630 million euros and proposed

to operate from 2028–2029, the TDF would allocate 25% of revenues generated from CBAM to partially reimburse the cost of purchasing ETS allowances. This would apply at the same time as free allowances are phased out from 2026, and, therefore, provides temporary support to sectors at high risk of carbon leakage following CBAM implementation. Eligible sectors include fertilizers, aluminum, and iron and steel producers.

The draft regulations now need to be negotiated and jointly adopted by the European Parliament and the Council, acting as co-legislators.

XXI. Administrative Cooperation in the Field of Taxation: From DAC 1 to DAC 9 and Beyond

A. General

Executive Summary

This Section discusses the basic 2011 Directive on administrative cooperation in the field of taxation (currently referred to as “DAC 1”) and its – to date – seven amendments commonly known as DAC 2 through DAC 8.

After discussing the key-features of the basic directive (XXI.B., below), the Section continues with a discussion of DAC 2 (exchange of financial account information), DAC 3 (tax rulings), DAC 4 (country-to-country reporting, including country-to-country reporting vis-à-vis the public), DAC 5 (anti-money laundering information), DAC 6 (intermediaries and cross-border arrangements), DAC 7 (digital platforms) and DAC 8 (e-money and crypto-assets). The Section ends with a discussion of DAC 9 (Pillar Two) that was launched by the Commission on October 28, 2024 and approved by the EU Council on April 14, 2025.

Council Directive 2011/16/EU, the basic directive on administrative cooperation in the field of taxation, now commonly referred to as “DAC 1,” was formally adopted on February 15, 2011 (see XXI.B., below).

DAC 1 has been amended and supplemented by Council Directive 2014/107/EU (“Financial Account Information” or DAC 2, see XXI.C., below), Council Directive (EU) 2015/2376 (“Tax Rulings” or DAC 3, see XXI.D., below), Council Directive (EU) 2016/881 (“Country-by-Country Reporting” or DAC 4, see XXI.E., below), Council Directive 2016/2258/EU (“Anti-Money-Laundering Information” or DAC 5, see XXI.F., below), Council Directive 2018/822/EU (“Intermediaries/Reportable Cross-Border Arrangements” or DAC 6, see XXI.G., below), Council Directive (EU) 2021/514 (“Digital Platforms” or DAC 7, see XXI.H., below), Council Directive (EU) 2023/2226 (“Crypto-Assets” or DAC 8, see XXI.I., below), and Council Directive (EU) 2025/872 (“Pillar Two” or DAC 9, see XXI.J., below).

B. DAC 1 — Administrative Cooperation in the Tax Field — “Basic” Directive

1. General

Council Directive 2011/16/EU on administrative cooperation in the tax field (DAC 1) repealed previous Council Directive 77/799/EEC concerning mutual assistance by the competent authorities of Member States in the field of direct taxation and taxation of insurance premiums. As a result of the tremendous development in the mobility of taxpayers, the number of cross-border transactions and the internationalization of financial instruments, there was a real need for a reinforced administrative cooperation instrument. In addition, the scope of Directive 77/799/EEC was limited to direct taxes and insurance premiums and, hence, did not cover indirect taxes that were not

yet dealt with in a separate EU act (i.e., value added tax (VAT) and excise duties).²⁰⁸³

While it builds on the achievements of Directive 77/799/EEC, DAC 1 provides for clearer and more precise rules governing administrative cooperation between Member States where necessary to establish, especially as regards the exchange of information, a wider range of administrative cooperation. In particular, the clearer rules were designed to make it possible to cover all legal and natural persons in the European Union, taking into account the ever-increasing range of legal arrangements: not only traditional arrangements such as trusts, foundations and investment funds, but also new instruments that may be set up by taxpayers in the Member States.²⁰⁸⁴

DAC 1 entered into force on January 1, 2013, with the exception of the provisions relating to the automatic exchange of information, which entered into force on January 1, 2015.

DAC 1 should be considered in conjunction with Commission Implementing Regulation (EU) 2015/2378 of December 15, laying down detailed rules for: standard forms for exchanges on request, spontaneous exchanges, and notifications and feedback; computerized formats for the mandatory automatic exchange of information; and practical arrangements regarding the use of the common communication network (CCN).²⁰⁸⁵

2. Subject Matter and Scope

DAC 1 aims to create a high-quality legal instrument to enhance administrative cooperation in the field of taxation and allow the smooth functioning of the internal market by circumventing the negative effects of harmful tax practices. This would bring cooperation in the field of taxation in line with the existing provisions on administrative cooperation in the fields of VAT and excise duties. To this end, DAC 1 sets out the rules and procedures under which the Member States are to cooperate with each other with a view to exchanging information (including by electronic means) that has foreseeable relevance to the administration and enforcement of the domestic laws of the Member States concerning the taxes falling within its scope.²⁰⁸⁶

Recital (9) of DAC 1 indicates that the standard of “foreseeable relevance” is intended to provide for the exchange of information in tax matters to the widest possible extent and,

²⁰⁸³ From 1979 until 1992, VAT was within the scope of Directive 77/799/EEC. Excise duties were also within the scope of that Directive from 1992 to 2004. However, as a result of the conclusions of the report of the high-level Council Working Party on fraud in May 2000, which identified the incapacity of the Directive to fulfill its objectives, the Commission presented two separate draft Regulations aimed at creating an entirely new environment for administrative cooperation for VAT and excise duties purposes. These Regulations were adopted on October 7, 2003 for VAT (Regulation 1798/2003) and November 16, 2004 for excise duties (Regulation 2073/2004). VAT and excise duties were therefore withdrawn from the scope of Directive 77/799/EEC. See the discussions at XVII.N.1. and XVIII.D., respectively).

²⁰⁸⁴ Council Directive 2011/16/EU (DAC 1), Recital (7).

²⁰⁸⁵ Commission Implementing Regulation (EU) 2015/2378 of December 15, 2015 provided detailed rules for implementing certain provisions of Council Directive 2011/16/EU on administrative cooperation in the field of taxation, and repealing Implementing Regulation (EU) No. 1156/2012, OJ L332/19. Commission Implementing Regulation (EU) 2015/2378 has been amended by Commission Implementing Regulations (EU) 2016/1963 of November 9, 2016, (EU) 2018/99 of January 22, 2018, (EU) 2019/532 of March 28, 2019, (EU) 2022/1467 of September 5, 2022, and (EU) 2025/1325 of July 7, 2025.

²⁰⁸⁶ DAC 1, Art. 1(1) and (2).

at the same time, to make it clear that Member States are not at liberty to engage in “fishing expeditions” or request information that is unlikely to be relevant to the tax affairs of a particular taxpayer. The Court of Justice of the European Union (CJEU) clarified the concept of “foreseeable relevance” in *Berlioz Investment Fund*.²⁰⁸⁷ In the Court’s view, the concept of “foreseeable relevance” reflects that used in Article 26 of the OECD Model Tax Convention, because of both the similarity between the concepts used and the reference to OECD conventions in the explanatory memorandum to the 2009 Commission proposal that led to the adoption of DAC 1. According to the commentary on that article adopted by the OECD Council on July 17, 2012, Contracting States are not at liberty “to engage in fishing expeditions” or to request information that is unlikely to be relevant to the tax affairs of a particular taxpayer. On the contrary, there must be a reasonable possibility that the requested information will be relevant. The aim of the concept of “foreseeable relevance” under Recital 9 of DAC 1 is thus to enable the requesting authority to obtain any information that seems to it to be justified for purposes of its investigation, while not authorizing it manifestly to exceed the parameters of that investigation or place an excessive burden on the requested authority. It follows that the “foreseeable relevance” of the information requested by one Member State from another Member State is a criterion that must be satisfied for the requested Member State to be required to comply with the request, and thus a criterion for the legality of the information order addressed by that Member State to a relevant person and of any penalty imposed on that person for failure to comply with that information order.

The taxes falling within the scope of DAC 1 are all taxes of any kind levied by, or on behalf of, a Member State or the Member State’s territorial or administrative subdivisions, including local authorities, other than VAT, customs duties and excise duties covered by other EU legislation on administrative cooperation between Member States²⁰⁸⁸, and compulsory social security contributions payable to a Member State, a subdivision of a Member State or a social security institution established under public law.²⁰⁸⁹ Fees (for example, for certificates and other documents issued by public authorities) or dues of a contractual nature (for example, consideration for public utilities) are outside the scope of DAC 1.²⁰⁹⁰

In general, the nationality or residence of the taxpayers involved is not relevant. Thus, the exchange of information can also involve persons who are neither nationals nor residents of a Member State. Residence becomes relevant only in the context of the automatic exchange of information and of financial account information (DAC 2, see XXI.C., below).²⁰⁹¹ The Directive intends term “person” to be interpreted in a very wide sense, i.e., as encompassing an individual, a corporation or a hybrid entity, including an association of persons and any oth-

er legal arrangement that owns or manages assets subject to the taxes covered by DAC 1.²⁰⁹²

DAC 1 does not affect the application in the Member States of the rules on mutual assistance in criminal matters. It is also without prejudice to compliance with any obligations of the Member States in relation to wider administrative cooperation ensuing from other legal instruments, including bilateral and multilateral agreements.²⁰⁹³

Information communicated under DAC 1 is to be provided, as far as possible, by electronic means using the CCN.²⁰⁹⁴ The CCN is the common platform developed by the European Union for all transmissions by electronic means between competent authorities in the area of customs and taxation.²⁰⁹⁵

As the rules in DAC 1 are “minimum” rules, DAC 1 does not affect the right of Member States to enter into wider cooperation with other Member States under their national legislation or within the framework of a bilateral or multilateral agreement concluded with other Member States.²⁰⁹⁶ Similarly, where a Member State provides wider cooperation to a third country than that provided for under DAC 1, that Member State may not refuse to provide such wider cooperation to any other Member State wishing to enter into such mutual wider cooperation with that Member State (i.e. the most favored nation (MFN) principle).²⁰⁹⁷

3. Institutional Framework

As regards the institutional framework for achieving the objectives discussed in XXI.B.1. and XXI.B.2., above), the rules and obligations applying with respect to “competent authority,” “central liaison office,” “liaison department,” and “competent officials” are similar to those that apply in the VAT administrative cooperation area (see XVII.N.1., above).²⁰⁹⁸

4. Types of Exchange of Information

a. Exchange of Information on Request

For purposes of DAC 1, the “exchange of information on request” means the exchange of information based on a request made by a requesting Member State to a requested Member State in a specific case.²⁰⁹⁹

At the request of the requesting authority, the requested authority must communicate to the requesting authority any information covered by DAC 1 that it has in its possession or that it obtains as a result of administrative enquiries. It must also arrange for the making of any administrative enquiries necessary to obtain such information. The request may contain a reasoned request for a specific administrative enquiry. “Administrative enquiry” means any control, check or other action performed by a Member State in carrying out its duties with a view to ensuring the proper application of tax legislation.²¹⁰⁰

²⁰⁹² DAC 1, Art. 3(11).

²⁰⁹³ DAC 1, Art. 1(c).

²⁰⁹⁴ DAC 1, Art. 21(1).

²⁰⁹⁵ DAC 1, Art. 3(13).

²⁰⁹⁶ DAC 1, Recital (21).

²⁰⁹⁷ DAC 1, Art. 19.

²⁰⁹⁸ DAC 1, Art. 4.

²⁰⁹⁹ DAC 1, Art. 3(8).

²¹⁰⁰ DAC 1, Art. 3(7).

²⁰⁸⁷ Case C-682/15, *Berlioz Investment Fund*.

²⁰⁸⁸ See the discussion at XVII. and XVIII.

²⁰⁸⁹ DAC 1, Art. 2(1) and (2). Art. 2 takes its lead from the Joint Council of Europe/OECD Convention on Mutual Administrative Assistance in Tax Matters.

²⁰⁹⁰ DAC 1, Art. 2(3).

²⁰⁹¹ DAC 1, Art. 8(1), Art. 3(9)(b) and Annex I, Section VIII.D.2.

DAC 1 does not impose an obligation on a competent authority to inform or consult the tax debtor with respect to incoming requests for information, which potentially raises legal protection concerns. In *Sabou*,²¹⁰¹ a case decided under Council Directive 77/799 (i.e., the predecessor of DAC 1, see XXI.B.1., above), the CJEU held that, while observance of the rights of defense is a general principle of EU law, the decision of a competent authority of a Member State to request assistance from a competent authority of another Member State and the latter's decision to examine witnesses for purposes of responding to that request do not constitute acts that, because of their consequences for the taxpayer, make it necessary for the taxpayer to be heard. The reason is that, in tax inspection procedures, the investigation stage, during which information is collected and that includes a request for information made by one tax authority to another, must be distinguished from the contentious (between the tax authorities and the taxpayer) stage, which begins when the taxpayer is sent the proposed adjustment. When they are gathering information, the authorities are not required to notify the taxpayer of this or obtain the taxpayer's point of view. The same applies to the reply made by the requested tax authorities and the inquiries carried out to that end by those authorities (including the examination of witnesses). It follows that respect for the rights of defense of the taxpayer does not require the taxpayer to take part in the request for information sent by the requesting Member State to the requested Member State. Nor does it require the taxpayer to be heard at the point when inquiries, which may include the examination of witnesses, are carried out in the requested Member State or before that Member State sends the information to the requesting Member State. Accordingly, the CJEU concluded that Directive 77/799 and the fundamental right to be heard confers on a taxpayer of a Member State neither the right to be informed of a request for assistance from that Member State addressed to another Member State (in particular to verify the information provided by the taxpayer in its income tax return) nor the right to take part in formulating the request addressed to the requested Member State.

Comment: In the author's opinion, the CJEU's reasoning and conclusion in *Sabou* may be extended, *mutatis mutandis*, to DAC 1.

If the requested authority takes the view that no administrative enquiry is necessary, it immediately informs the requesting authority of its reasons for that view. To obtain the requested information or to conduct the administrative enquiry requested, the requested authority is to follow the same procedures as it would when acting on its own initiative or at the request of another authority in its own Member State. When specifically requested to do so by the requesting authority, the requested authority must communicate original documents, provided this is not contrary to the provisions in force in the Member State of the requested authority.²¹⁰²

The requested authority must provide the information as quickly as possible and, in any event, no later than six months from the date of receipt of the request. However, where the requested authority is already in possession of the information,

the information is to be transmitted within two months of that date. In certain special cases, other time limits may be agreed on between the requested and the requesting authorities. The requested authority must:

- (i) Immediately and, in any event, no later than seven working days from receipt of a request, notify the requesting authority, if possible by electronic means, that it has received the request; and
- (ii) Within one month of receiving the request, notify the requesting authority of any deficiencies in the request and of the need for any additional background information. (If additional information is needed, the time limits are measured from the day after the requested authority receives the additional information).

If the requested authority is unable to respond to the request within the relevant time limit, it informs the requesting authority immediately, and, in any event, within three months of the receipt of the request, of the reasons for its failure to do so, and the date by which it considers it may be able to respond. Where the requested authority is not in possession of the requested information and is unable to respond to the request for information or refuses to do so because the requesting authority has not exhausted the usual sources of information that it could have used in the circumstances to obtain the information requested without running the risk of jeopardizing the achievement of its objectives,²¹⁰³ it informs the requesting authority of its reasons immediately and, in any event, within one month of receiving the request.²¹⁰⁴

In its judgment of September 26, 2024,²¹⁰⁵ the CJEU made it clear that the fact that the system for the exchange of information on request provided for by the DAC does not include provisions relating to the protection of the confidentiality of communications between a lawyer and his or her client, in the context of the collection of information for which the requested Member State is responsible, does not imply that the DAC infringes Article 7 and Article 52(1) of the Charter of Fundamental Rights of the European Union. This Charter protects the confidentiality of all correspondence between individuals and affords strengthened protection to exchanges between lawyers and their clients. According to the Court, it is for each Member State to ensure, in the context of the national procedures implemented for purposes of that collection, the enhanced protection of these communications guaranteed by the Charter.

b. Mandatory Automatic Exchange of Information

"Automatic exchange" means the systematic communication of predefined information to another Member State, without prior request, at pre-established regular intervals.²¹⁰⁶

DAC 1 recognizes that the mandatory automatic exchange of information without preconditions is the most effective means of enhancing the correct assessment of taxes in cross-border situations and of fighting fraud. To that end, a step-by-step approach is followed, starting with the automatic exchange of available information on five categories of income/

²¹⁰¹ Case C-276/12, *Sabou* (referring expressly to Case C-184/05, *Twoh International*).

²¹⁰² DAC 1, Arts. 5 and 6.

²¹⁰³ DAC 1, Art. 17(1).

²¹⁰⁴ DAC 1, Art. 7.

²¹⁰⁵ Case C-432/23, *Ordre des avocats du Barreau de Luxembourg*.

²¹⁰⁶ DAC 1, Art. 3(9).

capital (and a review of the relevant provisions after a report by the Commission).²¹⁰⁷ The competent authority of each Member State is to communicate, by automatic exchange, to the competent authority of any other Member State, information regarding taxable periods beginning on or after January 1, 2014 that is available concerning residents of that other Member State, with respect to the following specific categories of income and capital, as they are understood under the national legislation of the Member State communicating the information: (i) income from employment; (ii) director's fees; (iii) life insurance products not covered by other EU legal instruments on the exchange of information and other similar measures; (iv) pensions; and (v) the ownership of, and income from, immovable property.²¹⁰⁸ DAC 7 and DAC 8, respectively, added royalties and non-custodial dividend income to these categories.²¹⁰⁹

"Available" information means that only information retrievable in the tax files under national procedures for gathering and processing information in the Member State communicating the information needs to be exchanged under DAC 1.²¹¹⁰ Admittedly, this precondition may lead to asymmetries of exchange content among Member States.

The competent authority of a Member State may indicate to the competent authority of any other Member State (and inform the Commission accordingly) that it does not wish to receive information on the listed categories of income and capital, or that it does not wish to receive information on income or capital not exceeding a threshold amount.²¹¹¹

Information must be communicated at least once a year, within six months following the end of the tax year of the Member State during which the information became available.²¹¹²

Member States that agree on the automatic exchange of information for additional categories of income and capital in bilateral or multilateral agreements concluded with other Member States, must notify the Commission of those agreements, thus making the agreements available to all other Member States.²¹¹³

c. *Spontaneous Exchange of Information*

"Spontaneous exchange" means the non-systematic communication, at any moment and without prior request, of information to another Member State.²¹¹⁴

Spontaneous exchange entails an obligation on the part of the competent authority of each Member State to communicate the information covered by DAC 1 to the competent authority of another Member State where: (i) the competent authority of one Member State has grounds for supposing that there may be a loss of tax in the other Member State; (ii) a person liable to tax obtains a reduction in, or an exemption from, tax in one Member State that would give rise to an increase in tax or to

liability to tax in the other Member State; (iii) business dealings between a person liable to tax in one Member State and a person liable to tax in the other Member State are conducted through one or more countries in such a way that a saving in tax may result in one or the other Member State or in both; (iv) the competent authority of a Member State has grounds for supposing that a saving of tax may result from artificial transfers of profits within groups of enterprises; or (v) information forwarded to one Member State by the competent authority of the other Member State enables information to be obtained that may be relevant in assessing liability to tax in the latter Member State.²¹¹⁵ The competent authority to which any such information becomes available must forward that information to the competent authority of any other Member State concerned as quickly as possible and, in any event, no later than one month after it becomes available.²¹¹⁶ On the other hand, the competent authority of any Member State may communicate, by spontaneous exchange, to the competent authority of any other Member State any information of which it is aware and that may be useful to the competent authority of the other Member State.²¹¹⁷

5. *Other Forms of Administrative Cooperation*

a. *Presence in Administrative Offices and Participation in Administrative Enquiries*

By agreement between the requesting authority and the requested authority and in accordance with the arrangements laid down by the latter, officials authorized by the requesting authority may, with a view to exchanging the information covered by DAC 1: (i) be present in the offices at which the administrative authorities of the requested Member State carry out their duties; and/or (ii) be present during administrative enquiries made in the territory of the requested Member State.²¹¹⁸ To the extent permitted under the legislation of the requested Member State, such an agreement may provide that, where officials of the requesting authority are present during administrative enquiries, they may interview individuals and examine records. Any refusal by the person under investigation to respect the inspection measures of the officials of the requesting authority is to be treated by the requested authority as if that refusal were committed against officials of the latter authority.²¹¹⁹

b. *Simultaneous Controls*

Where two or more Member States agree to conduct simultaneous controls, in their own territory, of one or more persons of common or complementary interest to them, with a view to exchanging the information thus obtained, the following *modus operandi* applies: (i) the competent authority in each Member State identifies independently the persons with respect to which it intends to propose a simultaneous control and notifies the competent authority of the other Member States concerned of any cases with respect to which it proposes a simultaneous control, giving reasons for its choice and specifying the time period during which the controls are to be conducted; (ii)

²¹⁰⁷ DAC 1, Recital (10).

²¹⁰⁸ DAC 1, Art. 8(1).

²¹⁰⁹ See, respectively, XXI.H.3. and XXI.I.3.

²¹¹⁰ DAC 1, Art. 3(9).

²¹¹¹ DAC 1, Art. 8(3). A Member State may be regarded as not wishing to receive information if it does not inform the Commission of any single category with respect to which it has information available.

²¹¹² DAC 1, Art. 8(6).

²¹¹³ DAC 1, Art. 8(8).

²¹¹⁴ DAC 1, Art. 3(10).

²¹¹⁵ DAC 1, Art. 9(1).

²¹¹⁶ DAC 1, Art. 10(1).

²¹¹⁷ DAC 1, Art. 9(2).

²¹¹⁸ DAC 1, Art. 11(1).

²¹¹⁹ DAC 1, Art. 11(2).

the competent authority of each Member State concerned decides whether it wishes to take part in a simultaneous control and communicates its agreement or its reasoned refusal to the authority that proposed the simultaneous control; and (iii) the competent authority of each Member State concerned appoints a representative with responsibility for supervising and coordinating the control operation.²¹²⁰

c. Administrative Notification

At the request of the competent authority of a Member State, the competent authority of another Member State must notify the addressee of any instruments and decisions that emanate from the administrative authorities of the requesting Member State and concern the application in its territory of legislation on taxes covered by DAC 1. The requested authority must inform the requesting authority immediately of its response and, in particular, of the date on which it notified the addressee of the instrument or decision. However, the requesting authority can only make a request for notification when it is unable to give such notification under the rules governing the notification of the instruments concerned in the requesting Member State, or when giving such notification would give rise to disproportionate difficulties.²¹²¹

d. Feedback

A competent authority that provides information by exchange on request, by automatic exchange or by spontaneous exchange may ask the competent authority receiving the information to send feedback on the information provided. Such feedback, if requested, must be provided as soon as possible and, in any event, no later than three months after the outcome of the use of the requested information is known. Member States' competent authorities are to send feedback on the automatic exchange of information to the other Member States concerned once a year, in accordance with practical arrangements agreed on bilaterally.²¹²²

e. Sharing of Best Practices and Experience

Member States, together with the Commission, are to examine and evaluate administrative cooperation under DAC 1, share their experiences, with a view to improving such cooperation and, where appropriate, drawing up rules in the fields concerned, and produce guidelines on any aspect deemed necessary to sharing best practices and experience.²¹²³

6. Conditions Governing Administrative Cooperation

a. Disclosure of Information and Documents

Information communicated between Member States in any form under DAC 1 is covered by the obligation of official secrecy and enjoys the protection extended to similar information under the national law of the Member State receiving the information. Such information may be used for the administration and enforcement of the domestic laws of the Member States concerning the taxes covered by DAC 1. Such information may

also be used for the assessment and enforcement of other taxes and duties covered by Article 2 of Council Directive 2010/24/EU of March 16, 2010 concerning mutual assistance for the recovery of claims relating to taxes, duties and other measures, or for the assessment and enforcement of compulsory social security contributions. In addition, it may be used in connection with judicial and administrative proceedings that may involve penalties, initiated as a result of infringements of tax law, without prejudice to the general rules and provisions governing the rights of defendants and witnesses in such proceedings.²¹²⁴ With the permission of the competent authority of the Member State communicating information under DAC 1, and to the extent this is allowed under the legislation of the Member State of the competent authority receiving the information, information and documents received under DAC 1 may also be used for other purposes. Such permission must be granted if the information can be used for similar purposes in the Member State of the competent authority communicating the information.²¹²⁵

A competent authority of a Member State that considers that information it has received from the competent authority of another Member State is likely to be useful to the competent authority of a third Member State may transmit the information to the latter competent authority, provided the transmission is carried out in accordance with the rules and procedures laid down in DAC 1. It must inform the competent authority of the Member State from which the information originates of its intention to share the information with a third Member State. The Member State of the origin of the information may oppose such a sharing of information within 10 working days of receipt of the communication from the Member State wishing to share the information.²¹²⁶

Information, reports, statements and any other documents, or certified true copies or extracts of such documents obtained by the requested authority and communicated to the requesting authority in accordance with DAC 1 may be invoked as evidence by the competent bodies of the requesting Member State on the same basis as similar information, reports, statements and other documents provided by an authority of that Member State.²¹²⁷

b. Limits on Administrative Cooperation

A requested authority in one Member State is not obliged to provide a requesting authority in another Member State with information under the exchange of information on request procedure if the requesting authority has not exhausted the usual sources of information that it could have used in the circumstances to obtain the information requested without running the risk of jeopardizing the achievement of its objectives.²¹²⁸

Nor does the requested Member State have an obligation to carry out enquiries or to communicate information if it would be contrary to its legislation to conduct such inquiries or to collect the information requested for its own purposes.²¹²⁹ In addition, the competent authority of a requested Member State

²¹²⁰ DAC 1, Art. 12.

²¹²¹ DAC 1, Art. 13.

²¹²² DAC 1, Art. 14.

²¹²³ DAC 1, Art. 15.

²¹²⁴ DAC 1, Art. 16(1).

²¹²⁵ DAC 1, Art. 16(2).

²¹²⁶ DAC 1, Art. 16(3).

²¹²⁷ DAC 1, Art. 16(5).

²¹²⁸ DAC 1, Art. 17(1).

²¹²⁹ DAC 1, Art. 17(2).

may decline to provide information where the requesting Member State is unable, for legal reasons, to provide similar information, where the provision of information would lead to the disclosure of a commercial, industrial or professional secret or a commercial process, or where the disclosure of the information would be contrary to public policy.²¹³⁰ However, none of these grounds for refusal can be construed as permitting a requested authority to decline to supply information solely because the information is held by a bank, another financial institution, or a nominee or a person acting in an agency or a fiduciary capacity, or because it relates to ownership interests in a person.²¹³¹

7. Evaluation of Administrative Cooperation

The Member States and the Commission are to examine and evaluate the functioning of the administrative cooperation provided for in DAC 1. To this end, Member States communicate to the Commission any relevant information necessary for the evaluation of the effectiveness of administrative cooperation in combating tax evasion and tax avoidance, as well as a yearly assessment of the effectiveness of the automatic exchange of information and the practical results achieved.²¹³²

8. Exchange of Information with Third Countries

A competent authority of a Member State that receives from a third country information that has foreseeable relevance to the administration and enforcement of the domestic laws of that Member State concerning the taxes covered by DAC 1 may, to the extent allowed under an agreement with that third country, provide that information to the competent authorities of Member States to which the information might be useful and to any requesting authorities. At the same time, a competent authority may communicate, in accordance with its domestic provisions on the communication of personal data to third countries, information obtained under DAC 1 to a third country, provided: (i) the competent authority of the Member State from which the information originates consents to such communication; and (ii) the third country concerned has given an undertaking to provide the cooperation required to gather evidence of the irregular or illegal nature of transactions that appear to contravene, or constitute an abuse of, tax legislation.²¹³³

9. Reporting by Commission

Every five years after January 1, 2013, the Commission is to submit a report on the application of DAC 1 (as amended) to the European Parliament and the Council.²¹³⁴

²¹³⁰ DAC 1, Art. 17(3) and (4).

²¹³¹ DAC 1, Art. 18(2). Nonetheless, a Member State may refuse to transmit requested information where the information concerns taxable periods before January 1, 2011 or the transmission of the information could have been refused based on Directive 77/799/EEC, Art. 8(1) had the information been requested before March 11, 2011.

²¹³² DAC 1, Art. 23.

²¹³³ DAC 1, Art. 24.

²¹³⁴ DAC 1, Art. 27.

C. DAC 2 — Exchange of Financial Account Information

1. General

To help fight tax evasion and protect the integrity of tax systems, Directive 2014/107/EU, commonly referred to as “DAC 2,” introduced the automatic exchange of financial account information between Member States. DAC 2 implements within the European Union the Common Reporting Standard (CRS) developed by OECD and broadly applied at international level. The timing of the Directive was probably not coincidental. Some Member States had already implemented the CRS through their tax treaties with the United States with a view to making information available for Foreign Account Tax Compliance (FATCA) purposes, thus providing more cooperation than that allowed by DAC 1.²¹³⁵ DAC 2 therefore introduced the CRS at the EU level to avoid other Member States having to use DAC 1’s MFN clause (see XXI.B.2., above).

In essence, DAC 2 requires EU Member States to obtain information from their financial institutions and exchange that information with the Member State of residence of the taxpayer concerned. It sets out the financial account information (“reportable financial account information”) to be exchanged, the financial institutions required to report (“reporting financial institution”), the different types of accounts (“reportable accounts”) and taxpayers (“reportable persons”) covered, as well as the procedures to be followed by financial institutions.

By December 31, 2015, the Member States had to adopt and publish the laws, regulations and administrative provisions necessary to comply with DAC 2 and had to apply those measures with effect from January 1, 2016. The first information exchange between tax administrations took place in September 2017. From then on, the same process has taken place on an annual basis.

2. Scope

DAC 2 brings interest, dividends and other income generated by financial accounts, gross proceeds from the sale or redemption of assets held in financial accounts and financial account balances within the scope of the automatic exchange of information. These additional items relate to income paid directly or indirectly to beneficial owners who are natural persons, or capital held directly or indirectly by such persons.

In this respect, “reportable accounts” are financial accounts (of a depositary, custodial or similar character) maintained by Member States’ reporting financial institutions,²¹³⁶ such as custodial institutions, depositary institutions, invest-

²¹³⁵ See Joint Statement of the United States, France, Germany, Italy, Spain and the United Kingdom Regarding an Intergovernmental Approach to Improving International Compliance and Implementing FATCA, February 7, 2012; <https://home.treasury.gov/system/files/131/FATCA-Joint-Statement-US-Fr-Ger-It-Sp-UK-2-7-2012.pdf>.

²¹³⁶ DAC 2, Annex I, Section VIII, A.1: “The term ‘Reporting Financial Institution’ means any Member State Financial Institution that is not a Non-Reporting Financial Institution, whereby the term ‘Member State Financial Institution’ means: (i) any Financial Institution that is resident in a Member State, but excludes any branch of that Financial Institution that is located outside that Member State; and (ii) any branch of a Financial Institution that is not resident in a Member State, if that branch is located in that Member State.”

ment entities or specified insurance companies,²¹³⁷ and held by one or more “reportable persons” or by non-financial entities²¹³⁸ with one or more controlling persons who are reportable persons.²¹³⁹ “Reportable persons” are individuals and entities that are resident in another Member State (other than corporations whose stock is regularly traded on one or more established securities markets, governmental entities, international organizations, central banks and financial institutions).²¹⁴⁰ “Controlling persons” are natural persons who exercise control over an entity.²¹⁴¹ In the case of a trust, the term “controlling persons” means the settlor(s), the trustee(s) (if any), the beneficiary(ies) or class(es) of beneficiaries. In the case of an entity other than a trust, the term means persons in equivalent or similar positions.

The existing condition with respect to income initially within the scope of the DAC to the effect that information only has to be exchanged if it is “available” (see XXI.B.4.b., above) is not extended to the new items to be reported under DAC 2. Such information is expected to be “available,” as financial intermediaries are required to report it to tax administrations under the agreements that Member States have concluded (or would conclude after the entry into force of DAC 2) with the United States with respect to FATCA. In addition, DAC 2 removes the threshold below which a Member State may not wish to receive information from other Member States (see XXI.B.4.b., above).

3. Reporting and Due Diligence Requirements

Under DAC 2, each Member State is obliged to require reporting financial institutions to follow the reporting and due diligence rules set out in Annex I and II to DAC 2. Annex I distinguishes between: (i) general reporting and due diligence requirements (Sections I and II); (ii) due diligence for pre-existing individual accounts (Section III); (iii) due diligence for new individual accounts (Section IV); (iv) due diligence for pre-existing entity accounts (Section V); and (v) due diligence for new entity accounts (Section VI). Special due diligence rules (which apply in addition to the above due diligence procedures) are set out in Section VII. Annex II prescribes complementary reporting and due diligence rules for financial account information (for example, when there is a change in circumstances relative to the status of a reportable person).

Under the applicable reporting and due diligence rules set out in Annexes I and II to DAC 2, information collected by

reporting financial institutions concerning reportable accounts and submitted by them to the competent authority of their Member State is communicated by that competent authority, by automatic exchange, to the competent authority of the relevant other Member State(s). In summary, such information generally includes: (i) in the case of an individual, the name, address, tax identification number(s) (TIN(s)) and date and place of birth of each reportable person that is an account holder and, in the case of any entity that is an account holder and that, after application of due diligence rules consistent with the Annexes, is identified as having one or more controlling persons qualifying as reportable person, the name, address, and TIN(s) of the entity and the name, address, TIN(s) and date and place of birth of each reportable person; (ii) the account number (or functional equivalent in the absence of an account number); (iii) the name and identifying number (if any) of the reporting financial institution; (iv) the account balance or value (including, in the case of a cash value insurance contract or annuity contract, the cash value or surrender value) as of the end of the relevant calendar year or other appropriate reporting period or, if the account was closed during that year or period, the closure of the account; (v) in the case of a custodial account: (a) the total gross amount of interest, of dividends, and of other income generated with respect to the assets held in the account, in each case paid or credited to the account (or with respect to the account) during the calendar year or other appropriate reporting period; and (b) the total gross proceeds from the sale or redemption of Financial Assets paid or credited to the account during the calendar year or other appropriate reporting period with respect to which the reporting financial institution acted as a custodian, broker, nominee, or otherwise as an agent for the account holder; (vi) in the case of a depository account, the total gross amount of interest paid or credited to the account during the calendar year or other appropriate reporting period; and (vii) in the case of an account other than a custodial or depository account, the total gross amount paid or credited to the Account Holder with respect to the account during the calendar year or other appropriate reporting period with respect to which the reporting financial institution is the obligor or debtor, including the aggregate amount of any redemption payments made to the account holder during the relevant calendar year or other appropriate reporting period.

D. DAC 3 — Tax Rulings

1. General

A key component of the Commission’s Tax Transparency Package launched on March 18, 2015 was a Proposal for a Council Directive amending Directive 2011/16/EU as regards mandatory automatic exchange of information with respect to EU cross-border tax rulings.²¹⁴²

According to the Commission, tax rulings are primarily issued to provide legal certainty and are, in principle, not problematic. However, where used to offer selective tax advantages or shift profits artificially to low or no-tax locations, they distort competition and erode Member States’ tax bases. The Commission is already conducting State aid investigations into

²¹³⁷ Each as defined in DAC 2, Annex, Section VIII.C.

²¹³⁸ DAC 2, Annex I, Section VIII, D.6.

²¹³⁹ DAC 2, Annex I, Section VIII, D.1.

²¹⁴⁰ DAC 2, Annex I, Section VIII, D.2.

²¹⁴¹ DAC 2, Annex I, Section VIII, D.5. “Control” depends on the legal structure of the entity at issue. Control over an entity may be exercised through direct or indirect ownership or, if no person with such an ownership interest exists, by any natural person(s) who otherwise exercises control over the management of the entity. The term “Controlling Person” is consistent with the definition of “beneficial owner” in Art. 3(6) of the Anti-Money Laundering Directive (Directive (EU) 2015/849 of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC, as amended). To enable tax authorities to identify the controlling persons of intermediary structures, the amendments introduced by DAC 5 ensure that the authorities have access to beneficial ownership information collected under anti-money laundering (AML) legislation (see XXI.F.).

²¹⁴² COM (2015) 135 final, 2015/0068 (CNS), SWD (2015) 60 final.

a number of Member States' tax rulings and has asked all Member States to provide information on their tax ruling practices to determine whether selective tax advantages are creating competitive distortions in the Internal Market (see also XVI.B.3.d., above). The Commission's anticipates that the positive output from the mandatory exchange of cross-border tax rulings (including transfer pricing arrangements) is likely to be that: (i) Member States will receive information on tax rulings in other countries that will put them in an informed position to apply counter-measures as they see fit; (ii) the general public may view the measure as an active step towards ensuring that all taxpayers pay their fair share of taxes; (iii) peer pressure may encourage Member States to modify their rulings practices; and (iv) companies may limit their aggressive tax planning structures.

On October 6, 2015, the EU Council reached political consensus on what is perceived by some to be a "lite" version of the Commission Proposal, in particular with regard to: (i) the express limitation of the measures to legally binding rulings; and (ii) the reduced "retroactivity" of communication (limited to five years instead of the initially proposed 10 years). The directive was eventually adopted on December 8, 2015, as Council Directive (EU) 2015/2376 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation, commonly referred to as "DAC 3."

DAC 3 provides for the mandatory exchange of qualifying "advance cross-border rulings" and "advance pricing arrangements" (APAs).

2. "Advance Cross-Border Ruling" and "Advance Pricing Arrangement"

An "advance cross-border ruling"²¹⁴³ means any agreement, communication, or other instrument or action with similar effects, including one issued, amended or renewed in the context of a tax audit, that fulfills the following conditions: (i) it is issued, amended or renewed by, or on behalf of, the government or tax authority of a Member State, or a territorial or an administrative subdivision of a Member State, including a local authority, irrespective of whether it is effectively used; (ii) it is issued (or amended or renewed) to a particular person or group of persons, and that person or group of persons is entitled to rely on it; (iii) it concerns the interpretation or application of a legal or administrative provision concerning the administration or enforcement of national laws relating to taxes of the Member State, or a territorial or an administrative subdivision of a Member State, including a local authority; (iv) it relates to a cross-border transaction or the question of whether activities carried on by a person in another jurisdiction create a permanent establishment (PE); and (v) it is made in advance of the transactions or of the activities in another jurisdiction potentially creating a PE or in advance of the filing of a tax return covering the period in which the transaction or series of transactions or activities took place. The cross-border transaction may involve, but is not restricted to, the making of investments, the provision of goods, services and finances, or the use of tangible or intangible assets, and need not directly involve the person receiving the advance cross-border ruling.

²¹⁴³ DAC 1, Art. (3)(14) of DAC 1, as inserted by DAC 3.

For this purpose, "cross-border transaction"²¹⁴⁴ means a transaction or series of transactions where: (i) not all of the parties to the transaction or series of transactions are resident for tax purposes in the Member State issuing, amending or renewing the advance cross-border ruling; (ii) any of the parties to the transaction or series of transactions is simultaneously resident for tax purposes in more than one jurisdiction; (iii) one of the parties to the transaction or series of transactions carries on business in another jurisdiction through a PE and the transaction or series of transactions forms part or the whole of the business of the PE; a cross-border transaction or series of transactions also includes an arrangement made by a person with respect to business activities in another jurisdiction that that person carries on through a PE; or (iv) the transaction or series of transactions has a cross-border impact.

An "advance pricing arrangement"²¹⁴⁵ means any agreement, communication or other instrument or action with similar effects, including one issued, amended or renewed in the context of a tax audit that fulfills the following conditions: (i) it is issued, amended or renewed by, or on behalf of, the government or tax authority of one or more Member States, including a territorial or administrative subdivision of a Member State, including a local authority, irrespective of whether it is effectively used; (ii) it is issued (or amended or renewed) to a particular person or group of persons and that person or group of persons is entitled to rely on it; and (iii) it determines in advance of cross-border transactions between associated enterprises, an appropriate set of criteria for the determination of the transfer pricing for those transactions or it determines the attribution of profits to a PE.

For this purpose, a "cross-border transaction"²¹⁴⁶ means a transaction or series of transactions involving associated enterprises that are not all resident for tax purposes in the territory of a single jurisdiction or a transaction or series of transactions that have a cross-border impact. An "enterprise" means any form of conducting business. Two enterprises are associated enterprises where one enterprise participates directly or indirectly in the management, control or capital of the other enterprise or the same persons participate directly or indirectly in the management, control or capital of both enterprises. Transfer prices are the prices at which an enterprise transfers physical goods and intangible property or provides services to associated enterprises, and the term "transfer pricing" is to be construed accordingly.

3. Scope and Conditions of Mandatory Exchange of Information

Article 8a of DAC 1, as inserted by Article 1(3) of DAC 3, defines the scope of, and conditions for, the mandatory automatic exchange of information on advance cross-border rulings and APAs. Under DAC 3, the competent authority of a Member State is obliged to communicate information to the competent authorities of all other Member States as well as to the

²¹⁴⁴ DAC 1, Art. 3(16), para. 1, as inserted by DAC 3.

²¹⁴⁵ DAC 1, Art. 3(15), as inserted by DAC 3.

²¹⁴⁶ DAC 1, Art. 3(16) para. 2, as inserted by DAC 3.

Commission on advance cross-border rulings and APAs issued, amended or renewed after December 31, 2016.²¹⁴⁷

Under DAC 3, there is no mandatory exchange of information in a case where an advance cross-border ruling exclusively concerns and involves the tax affairs of one or more natural persons. See, however, the change introduced by DAC 8 extending the mandatory exchange of information to high-net-worth individuals who hold a minimum of 1,000,000 euros in financial or investable wealth or assets under management, excluding the relevant individual's main private residence (see XXI.I.3., below). The amendment obliges Member States to exchange with other Member States information on advance cross-border rulings for high-net-worth individuals issued, amended or renewed between January 1, 2020 and December 31, 2025, under the condition that the rulings are still valid on January 1, 2026.

The information to be communicated by a Member State under DAC 3 includes:²¹⁴⁸

- (i) The identity of the person concerned, other than a natural person, and where appropriate the group of persons to which it belongs;
- (ii) A summary of the content of the advance cross-border ruling or APA, including a description of the relevant business activities or transactions or series of transactions provided in abstract terms, without leading to the disclosure of a commercial, industrial or professional secret, a commercial process or information whose disclosure would be contrary to public policy;
- (iii) The dates of issue, amendment or renewal of the advance cross-border ruling or APA;
- (iv) The start date of the period of validity of the advance cross-border ruling or APA, if specified;
- (v) The end date of the period of validity of the advance cross-border ruling or APA, if specified;
- (vi) The type of advance cross-border ruling or APA;

(vii) The amount of the transaction or series of transactions that is the subject of the advance cross-border ruling or APA if the ruling or APA indicates that amount;

(viii) A description of the set of criteria used to determine the transfer pricing or the transfer price itself in the case of an APA;

(ix) The nature of method used to determine the transfer pricing or the transfer price itself in the case of an APA;

(x) The other Member States, if any, likely to be concerned by the advance cross-border ruling or APA; and

(xi) The identities of any persons, other than natural persons, in the other Member States, if any, likely to be affected by the advance cross-border ruling or APA (indicating the Member States with which the affected persons are connected).

Information under (i), (ii), (viii) and (xi) is not communicated to the Commission.

A bilateral or multilateral APA with a third country is excluded from the scope of the automatic exchange of information where the international tax agreement under which the APA was negotiated does not permit its disclosure to third parties.²¹⁴⁹ However, such a bilateral or multilateral APA will be exchanged under Article 9 where the international tax agreement under which the APA was negotiated permits its disclosure and the competent authority of the third country gives permission for the information to be disclosed.

The competent authorities of the Member States likely to be concerned by the advance cross-border ruling or APA must confirm, if possible, by electronic means, the receipt of the information to the competent authority that provided the information without delay and in any event no later than seven working days after receipt. This measure will apply until the directory referred to in Article 21(5) of DAC 3 (see XXI.D.4., below) becomes operational. Member States may request additional information, including the full text of an advance cross-border ruling or APA.

4. Central Directory

Under new Article 21(5) of DAC 3, the Commission had to develop, and provide technical and logistical support for, a secure Member State central directory on administrative cooperation in the field of taxation where information to be communicated in the framework of the Tax Ruling Directive is to be recorded. The competent authorities of all Member States have access to the information recorded in that directory. The Commission also has access to the information recorded in the directory, subject to the limitations set out in XXI.D.3., above.

²¹⁴⁷ The competent authority of a Member State was obliged to communicate information to the competent authorities of all other Member States as well as to the Commission on advance cross-border rulings and APAs issued, amended or renewed within a period beginning five years before January 1, 2017. The exchange of information was to take place within three months following the end of the half of the calendar year during which the advance cross-border ruling or APA concerned was issued, amended or renewed. In the case of advance cross-border rulings and APAs issued, amended or renewed between January 1, 2012 and December 31, 2013, such communication had to take place if the rulings or APAs were still valid on January 1, 2014. In the case of advance cross-border rulings and APAs issued, amended or renewed between January 1, 2014 and December 31, 2016, such communication had to take place irrespective of whether rulings or APAs were still valid. The exchange of information was to take place before January 1, 2018. Member States were allowed to exclude from the communication information on advance cross-border rulings and APAs issued, amended or renewed before April 1, 2016, to a particular person or group of persons, excluding those conducting mainly financial or investment activities, with a group-wide annual net turnover of less than 40 million euros (or the equivalent amount in any other currency) in the fiscal year preceding the date on which the cross-border rulings or APAs were issued, amended or renewed.

²¹⁴⁸ DAC 1, Art. 8a, para. 6, as inserted by DAC 3.

²¹⁴⁹ Where a bilateral or multilateral advance pricing arrangement (APA) would be so excluded from the automatic exchange of information, the information identified in DAC 1, Art. 8a, para. 6 referred to in the request that led to the issuance of the APA must instead be exchanged under Art. 8a, paras. 1 and 2. In these circumstances, the information to be communicated will also include an indication as to whether the information is based on the APA itself or on the request that led to the issuance of the APA.

5. Confidentiality of Information

Information communicated to the Commission under DAC 3 is to be kept confidential and may not be used for any purposes other than those required to determine whether and to what extent Member States are in compliance with the Directive. Information communicated to the Commission by a Member State, as well as any report or document produced by the Commission using such information, may be transmitted to other Member States. Such transmitted information is covered by the obligation of official secrecy and enjoys the protection extended to similar information under the national law of the Member State that receives it. Any such report or document produced by the Commission may be used by the Member States only for analytical purposes, and will not be published or made available to any other person or body without the express agreement of the Commission.

6. Comments

A number of aspects of the rules set forth by DAC 3 have attracted criticism or concern, including the following.

First, even though “domestic” rulings are excluded from the scope of the Directive, it will be hard to argue that they are completely excluded since such rulings may in effect have cross-border ramifications or implications.

Second, as mandatory exchange is only provided for with respect to legally binding rulings, “non-binding” communications and “informal” rulings will not find their way into the tax ruling database. This raises the issue of whether this is likely to result in a “renaissance” of the latter kind of instrument. There is also uncertainty regarding the precise borderline between “binding” and “non-binding” communications.

Third, under DAC 3, pre-2012 tax rulings are excluded as the “retroactivity” of communication was reduced to five years (instead of the initially proposed 10 years), which will undoubtedly impact the conduct of “peer-to-peer” reviews among Member States.

Fourth, the Commission is explicitly prevented from doing anything with the information, to which it anyway only has very limited access, other than ensuring that the information conforms to DAC 3 and that DAC 3 is properly applied (for example, the Commission has no access for State aid purposes).

Finally, Member States issuing tax rulings are likely to be confronted with an increased administrative burden and compliance costs directly related to providing information on rulings and APAs.

E. DAC 4 — Country-by-Country Reporting

1. General

On May 25, 2016, the Council adopted Council Directive (EU) 2016/881 amending DAC 1 as regards the mandatory automatic exchange of information in the field of taxation, i.e. the “Country-by-Country Reporting Directive,” commonly referred to as “DAC 4”). Article 2 of DAC 4 required Member States to adopt and publish, by June 4, 2017, the laws, regulations and administrative provisions necessary to comply with DAC 4 and to apply those provisions from June 5, 2017.²¹⁵⁰

In its country-by-country (CbC) report, an MNE group²¹⁵¹ must provide, annually and for each tax jurisdiction in which it does business, the amount of its revenue, profit before income tax, and income tax paid and accrued. An MNE group must also report the number of its employees, and its stated capital, accumulated earnings and tangible assets in each tax jurisdiction. Finally, an MNE group must identify each entity in the group doing business in a particular tax jurisdiction and must provide an indication of the business activities in which each such entity engages.

This information should enable the tax authorities to react to harmful tax practices by making changes in legislation or by undertaking adequate risk assessments and tax audits, and to identify whether companies have engaged in practices that have the effect of artificially shifting substantial amounts of income into tax-advantaged environments. Increased transparency should also incentivize MNE groups to abandon certain practices and pay their fair share of tax in the countries in which profits are made.

The DAC 4 transparency requirements should ensure that the administrative burden imposed on businesses is minimized. Thus, an EU MNE group is in principle not obliged to submit the information to all of the EU Member States in which it operates, but only to the tax authorities of its country of residence. DAC 4 requires a Member State, once it has received a CbC report, to share the information with the Member States in which, based on the information in the report, companies of the MNE group are either resident for tax purposes, or subject to tax with respect to the business carried out through a PE. To ensure the reporting burden and the benefit to tax administrations are appropriately balanced, only MNE groups with total consolidated group revenue of 750 million euros or more are obliged to file CbC reports. According to OECD estimates, approximately 85% to 90% of MNE groups will be excluded from the requirement, but the CbC report will nevertheless be filed by MNE groups controlling approximately 90% of corporate revenues.

DAC 4 should be seen in close conjunction with the final OECD reports of October 5, 2015 on base erosion and profit shifting (BEPS). More specifically, the work on BEPS Action 13 resulted in a set of standards for providing information on MNE groups’ transfer pricing positions, including the master file, the local file, and the CbC report. DAC 4 is intended to contribute to the implementation in the European Union of the CbC report and, at the same time, to achieve a degree of uniformity in the implementation of BEPS Action 13 across the European Union. Recital (17) of DAC 4 expressly specifies that, in implementing the Directive, Member States are to use the 2015

²¹⁵⁰ Under the Commission Proposal, these dates were December 31, 2016 and January 1, 2017, respectively.

²¹⁵¹ DAC 4, Annex III, Section I defines an “MNE Group” as “any Group that includes two or more enterprises the tax residence of which is in different jurisdictions, or includes an enterprise that is resident for tax purposes in one jurisdiction and is subject to tax with respect to the business carried out through a permanent establishment in another jurisdiction, and is not an Excluded MNE Group” (i.e., a group with a total consolidated group revenue of less than 750 million euros (or the equivalent in local currency) with respect to any fiscal year of the group). For these purposes, “Group” means a collection of enterprises so related through ownership or control that it is either required to prepare a consolidated financial statement for financial reporting purposes under applicable accounting principles or would be so required if equity interests in any of the enterprises were traded on a public securities exchange.

OECD final report on BEPS Action 13 as a source for illustrating or interpreting DAC 4 and to ensure consistency of application across Member States.

DAC 4 has been specifically designed to allow the automatic information exchange on CbC reporting to build on the existing rules in DAC 1 relating to the practical arrangements for exchanging information, including the use of standard forms.

2. Amendment of Definition of “Automatic Exchange”

Article 1 of DAC 4 amends the DAC 1 definition of “automatic exchange” to mean: (i) for purposes of Article 8(1) and Articles 8a and 8aa (see XXI.E.3., below), the systematic communication of predefined information to another Member State, without prior request, at pre-established regular intervals; for purposes of: (i) Article 8(1), the reference to available information relates to information in the tax files of the Member State communicating the information that is retrievable under the procedures for gathering and processing information in that Member State; (ii) Article 8(3a), the systematic communication of predefined information on residents of other Member States to the relevant Member State of residence, without prior request, at pre-established regular intervals; and (iii) the provisions of the Directive other than Article 8(1) and 8(3a), Article 8a and Article 8aa, the systematic communication of predefined information provided for in (i) and (ii).

3. Scope and Conditions of Mandatory Exchange of Information on CbC Reports

New Article 8aa inserted in Section II of Chapter II of DAC 1 defines the scope of, and conditions for, the mandatory automatic exchange of information on CbC reports, as follows:

(i) Each Member State must take the necessary measures to require the Ultimate Parent Entity²¹⁵² (UPE) of an MNE Group that is resident for tax purposes in its territory, or any other Reporting Entity (as provided in Section II of Annex III), to file a CbC report with respect to its Reporting Fiscal Year within 12 months after the last day of the reporting fiscal year of the MNE Group under Section II of Annex III;

(ii) The competent authority of a Member State that receives a CbC Report is obliged, by means of automatic exchange, to communicate the report to any other Member

State in which, based on the information in the report, one or more Constituent Entities of the MNE Group of the Reporting Entity²¹⁵³ are either resident for tax purposes or are subject to tax with respect to business carried on through a PE within 15 months after the last day of the fiscal year of the MNE Group to which the CbC report relates. The first CbC report is to be submitted for the fiscal year of an MNE Group commencing on or after January 1, 2016.

(iii) The CBC report must contain the following information with respect to an MNE Group:

- Aggregate information relating to the amount of revenue, profit (loss) before income tax, income tax paid, income tax accrued, stated capital, accumulated earnings, number of employees, and tangible assets other than cash or cash equivalents with regard to each jurisdiction in which the MNE Group operates; and
- The identity of each Constituent Entity of the MNE Group, setting out the jurisdiction of tax residence of each such Entity and, where this differs from the jurisdiction of tax residence, the jurisdiction under the laws of which each Constituent Entity is organized, and the nature of the main business activity or activities of each such Entity.

A new paragraph 6 is added to Article 20 of DAC 1, essentially to the effect that the automatic exchange of information on CbC reports under Article 8aa is to be carried out using the standard form provided in Tables 1, 2 and 3 of Section III of Annex III.

A new paragraph 6 in Article 21 of DAC 1 requires information communicated under Article 8aa(2) to be provided by electronic means using the CCN network. To this end, the Commission was mandated to adopt the necessary practical arrangements for the upgrading of the CCN network by means of implementing acts.

DAC 4 requires Member States to lay down rules on penalties applicable in the case of infringements of national provisions adopted under the Directive and concerning Article 8aa, and to take all measures necessary to ensure they are implemented. The penalties provided for should be effective, proportionate and dissuasive (new Article 25a).

4. Country-by-Country Reporting vis-à-vis the Public

Although, strictly speaking, country-by-country reporting vis-à-vis the public has no actual nexus with administrative co-operation in the tax field, it is worth noting the existence of Directive (EU) 2021/2101 of November 24, 2021 amending Directive 2013/34/EU as regards disclosure of income tax information by certain undertakings and branches.²¹⁵⁴

In its Communication of January 28, 2016,²¹⁵⁵ on an external strategy for effective taxation, the Commission stated that,

²¹⁵³ “Reporting Entity” means the Constituent Entity that is required to file a country-by-country (CbC) report in its jurisdiction of tax residence on behalf of an MNE Group.

²¹⁵⁴ Directive (EU) 2021/2101 of the European Parliament and of the Council of November 24, 2021 amending Directive 2013/34/EU as regards disclosure of income tax information by certain undertakings and branches.

²¹⁵⁵ Communication on an external strategy for effective taxation, January 28, 2016, COM (2016) 24 final.

²¹⁵² “Ultimate Parent Entity” (UPE) means a Constituent Entity of an MNE Group that satisfies the following criteria: (i) it owns directly or indirectly a sufficient interest in one or more other Constituent Entities of the MNE Group such that it is required to prepare Consolidated Financial Statements under accounting principles generally applied in its jurisdiction of tax residence or would be so required if its equity interests were traded on a public securities exchange in its jurisdiction of tax residence; and (ii) there is no other Constituent Entity of the MNE Group that owns directly or indirectly an interest described in (i) in the first mentioned Constituent Entity. “Constituent Entity” means: (i) any separate business unit of an MNE Group that is included in the Consolidated Financial Statements of the MNE Group for financial reporting purposes, or would be so included if equity interests in that business unit were traded on a public securities exchange; (ii) any business unit that is excluded from the MNE Group’s Consolidated Financial Statements solely on size or materiality grounds; and (iii) any PE of any separate business unit of the MNE Group included in (i) or (ii), provided the business unit prepares a separate financial statement for the PE for financial reporting, regulatory, tax reporting or internal management control purposes.

while public CbC reporting requirements had already been established for the banking and financial sector (Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (CRD IV)) and for logging and extractive industries under the Accounting Directive (Directive 2013/34/EU on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings), work was underway to determine whether public transparency requirements should be applied to companies operating in other sectors in the European Union. It added that a legislative proposal in this regard was to be expected in April 2016, which effectively followed on April 12, 2016 (Proposal for a directive amending Directive 2013/34/EU (the “Accounting Directive”))²¹⁵⁶ as regards the disclosure of income tax information by certain undertakings and branches).²¹⁵⁷ The Commission’s proposed legislation was eventually adopted as Directive 2021/2101. Member States were required to transpose the Directive into their national laws by June 22, 2023 and to apply the relevant rules, at the latest, from the commencement date of the first financial year starting on or after June 22, 2024.

Directive 2021/2101 is closely linked to, and complements, the CbC reporting component of the Anti-tax Avoidance Directive (ATAD) but has a different purpose, which is to enable and enhance transparency and the effective public scrutiny of corporate income taxes borne by multinational undertakings carrying on activities in the European Union. This in turn is designed further to foster corporate responsibility, contribute to welfare through taxes, promote fairer tax competition within the European Union via better informed public debate and restore public trust in the fairness of the Member States’ national tax systems.

Under the Directive, any multinational company — whether EU or not — that is currently active in the EU single market, has a permanent presence in the European Union and has a turnover (total consolidated group revenue) in excess of 750 million euros²¹⁵⁸ must comply with the additional transparency requirements introduced by the Directive. The 750 million-euro threshold is calculated on a worldwide basis and qual-

ifying MNE groups are required to submit information on their worldwide activities.

The information to be disclosed on a country-by-country basis includes: (i) a brief description of the nature of the activities; (ii) the number of employees; (iii) the amount of net turnover, including turnover made with third parties as well as between companies within the group; (iv) the amount of profit or loss before income tax; (v) the amount of income tax accrued (current year), i.e., the current tax expense recognized on taxable profits or losses of the financial year by undertakings and branches resident for tax purposes in the relevant tax jurisdiction (the current tax expense relates only to the activities of an undertaking in the current financial year and does not include deferred taxes or provisions for uncertain tax liabilities); (vi) the amount of income tax paid, i.e., the amount of income tax paid during the relevant financial year by undertakings and branches resident for tax purposes in the relevant tax jurisdiction; and (vii) the amount of accumulated earnings. This information must be disclosed for every EU Member State in which a company is active, as well as for tax havens. Aggregate figures also need to be provided for operations in other tax jurisdictions in the rest of the world. Reporting also requires the inclusion of explanations of discrepancies between the amounts of income tax actually paid and income tax accrued. The information is to be made available in a stand-alone report accessible to the public for at least five consecutive years on the company’s website. Qualifying companies also need to file the report with a business register in the European Union.

F. DAC 5 — Anti-Money Laundering Information

Council Directive (EU) 2016/2258 of December 6, 2016,²¹⁵⁹ commonly referred to as “DAC 5,” requires Member States to provide by law for access by tax authorities to the mechanisms, procedures, documents and information referred to in Articles 13 (customer due diligence measures), 30 (beneficial ownership information), 31 (trusts and similar other types of legal arrangements) and 40 (record-retention) of the Anti-Money Laundering Directive.²¹⁶⁰

In other words, DAC 5 ensures that tax authorities have access to beneficial ownership information collected under anti-money laundering (AML) legislation, as amended from time to time,²¹⁶¹ thus granting tax authorities the necessary tools to

²¹⁵⁶ Since the Commission DAC 4 Proposal did not propose the harmonization of taxes but instead referred to financial reporting obligations as regards income tax information, TFEU, Art. 50, which concerns the right of establishment and is the regular legal basis for initiatives in the area of company law, accounting and corporate financial reporting, was determined to be the appropriate legal basis. See also Case C-97/96, *Verband deutscher Daihatsu-Händler*, where the CJEU emphasized that TFEU, Art. 50(2)(g) refers to the need to protect the interests of “others” generally, without distinguishing or excluding any categories falling within the ambit of that term. Reliance on Art. 50 as the legal basis means that the Commission proposal was subject to qualified majority voting, not unanimity as is the case for legislation dealing with the harmonization of tax rules.

²¹⁵⁷ COM (2016) 198 final — 2016/0107 (COD), {SWD (2016) 117 final} {SWD (2016) 118 final}.

²¹⁵⁸ The 750-million euro turnover threshold is intended to capture only top-tier companies that, because of their size and complexity, are best equipped to engage in aggressive tax planning to the potential detriment of smaller SME competitors. No reference is made to the number of employees, as even companies with only a few employees may make significant taxable profits. In practical terms, the threshold is expected to cover companies controlling approximately 90% of corporate revenues made by multinationals, according to OECD figures. Also, it is reported to be consistent with the international approach agreed to in November 2015 by the G20 leaders as part of the BEPS Action Plan.

²¹⁵⁹ Council Directive (EU) 2016/2258 of December 6, 2016 amending Directive 2011/16/EU as regards access to anti-money laundering information by tax authorities.

²¹⁶⁰ Directive (EU) 2015/849 of the European Parliament and of the Council of May 20, 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC.

²¹⁶¹ On May 30, 2024, the Council of the European Union adopted a package of new rules targeted at money laundering and countering the financing of terrorism (AML/CFT). The package consists of: (i) an EU “single rulebook” regulation, which will officially enter into force on July 10, 2027, and includes all rules applicable to the private sector designed to protect the EU internal market from money laundering and the financing of terrorism; (ii) a Regulation establishing a new EU anti-money laundering authority (AMLA), which will officially apply from July 1, 2025; and (iii) a new Directive on anti-money-laundering mechanisms at the national level (6th AML Directive), which must be transposed into national legislation by July 10, 2027. The package was published in the Official Journal of the European Union on June 19, 2024.

monitor efficiently the application by financial institutions of the due diligence procedures set out in DAC 2 (see XXI.C., above). In the absence of access by the tax authorities to the AML information, those authorities would not be able to monitor, confirm and audit that the financial institutions are correctly identifying and reporting on the beneficial owners of intermediary structures.²¹⁶²

G. DAC 6 — Intermediaries and Reportable Cross-Border Arrangements

1. General

On May 25, 2018, the Council adopted Council Directive (EU) 2018/822 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements, commonly known as “DAC 6”.²¹⁶³

DAC 6 is designed to impose an obligation on qualifying intermediaries (or in certain cases the relevant taxpayers²¹⁶⁴) to disclose potentially aggressive cross-border tax planning arrangements or series of arrangements to their tax administration, coupled with the automatic exchange of information on such arrangements among Member States’ national tax administrations.

The fact that DAC 6 does not limit the reporting obligation to corporation tax but makes it applicable to all taxes falling within its scope does not affect the validity of DAC 6 in light of the general EU law principles of equal treatment and nondiscrimination, or of the equality and non-discrimination principles laid down in Articles 20 and 21 of the Charter of Fundamental Rights.²¹⁶⁵

Member States were to adopt and publish, the laws, regulations and administrative provisions necessary to comply with DAC 6 by December 31, 2019, at the latest, and to apply those provisions from July 1, 2020 (see XXI.G.5., below).

In the CJEU’s view, the degree of precision and clarity of the terminology used in the provisions of DAC 6 does not call into question the validity of that Directive in light of the principles of legal certainty and legality in criminal matters. Also, the interference with the private life of the intermediary and the relevant taxpayer entailed by the reporting obligation is defined

in a sufficiently precise manner in view of the information that that reporting must contain.²¹⁶⁶

2. “Intermediary”

For purposes of DAC 6, an “intermediary” means any person that designs, markets, organizes or makes available for implementation, or manages the implementation of, a reportable cross-border arrangement. It also means any person that, having regard to the relevant facts and circumstances and based on available information and the relevant expertise and understanding required to provide such services, knows or could be reasonably expected to know that it has undertaken to provide, directly or by means of other persons, aid, assistance or advice with respect to designing, marketing, organizing, making available for implementation or managing the implementation of a reportable cross-border arrangement.

The definition thus includes lawyers, tax advisers, accountants and other professionals that advise taxpayers on cross-border transactions and can also catch lawyers, banks and service providers involved in the implementation of these transactions. An in-house legal team that advises a group company on a cross-border arrangement may likewise be an “intermediary.”

To be an intermediary, a person must have a link to an EU Member State. That will be the case if the person: (i) is resident for tax purposes in a Member State; (ii) has a PE in a Member State through which the services with respect to the reportable cross-border arrangement are provided; (iii) is incorporated in, or governed by the laws of, a Member State; or (iv) is registered with a professional association related to legal, taxation or consultancy services in a Member State.

All intermediaries involved in a transaction individually have an obligation to file. However, where there is a multiple reporting obligation, an intermediary is exempt from filing the information if it has proof, in accordance with national law, that the same information has been filed in another Member State.

Each Member State may²¹⁶⁷ introduce the measures necessary to give intermediaries the right to a waiver from filing information on a reportable cross-border arrangement where they are entitled to legal professional privilege under the national law of that Member State. In such circumstances, the obligation to file information on an arrangement or a series of arrangements is the responsibility of the taxpayer and intermediaries must inform taxpayers of this responsibility as a result of the existence of the privilege. In other words, in such circumstances, the intermediary entitled to legal professional privilege protected under the national law of the relevant Member State must notify, without delay, any other intermediary or the relevant taxpayer of their reporting obligations *vis-à-vis* the competent authorities. In the CJEU’s opinion,²¹⁶⁸ however, this obligation to notify entails an interference with the right to respect for communications between lawyers and their clients, guaranteed in Article 7 of the Charter of Fundamental Rights of

²¹⁶² DAC 5, Recital (3).

²¹⁶³ Council Directive (EU) 2018/822 of May 25, 2018 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements, *OJ L 139*, 5.6.2018; see for the Commission Proposal: COM (2017) 335 final; 2017/0138 (CNS). See also {SWD (2017) 236 final} and {SWD (2017) 237 final}. The rules are inspired by OECD BEPS Action 12, Mandatory Disclosure Rules.

²¹⁶⁴ A relevant taxpayer is any person to whom a reportable cross-border arrangement is made available for implementation, or who is ready to implement a reportable cross-border arrangement or has implemented the first step of such an arrangement.

²¹⁶⁵ Case C-623/22, *Belgian Association of Tax Lawyers and Others*. Although the Commission’s Impact Assessment accompanying the DAC 6 proposal attached more importance to direct taxes, any type of tax or duty is susceptible to aggressive tax planning. While DAC 6 excludes VAT, customs duties and excise duties covered by other EU legislation on administrative cooperation between Member States, the reporting obligation may extend to other direct income taxes and indirect taxes or duties in light of the DAC 6 objectives.

²¹⁶⁶ Case C-623/22, *Belgian Association of Tax Lawyers and Others*.

²¹⁶⁷ Meaning that the exemption is at the discretion of the Member States. Also, not all Member States have a principle of legal professional privilege that covers advisory rather than litigation matters.

²¹⁶⁸ Case C-694/20, *Orde van Vlaamse Balies and Others*.

the European Union.²¹⁶⁹ According to the Court, the obligation to notify has the consequence that other (notified) intermediaries become aware of the identity of the lawyer-intermediary; they also become aware of the lawyer-intermediary's analysis to the effect that the tax arrangement at issue is reportable and of the lawyer-intermediary having been consulted in connection with the arrangement. The Court therefore held that the obligation to notify laid down by DAC 6 infringes the right to respect for communications between a lawyer and his or her client and, hence, is invalid.

On July 29, 2024, in the follow-up case *Belgian Association of Tax Lawyers and Others*,²¹⁷⁰ the CJEU provided further clarification to the effect that, for purposes of DAC 6, the concept of “lawyers” is limited to lawyers as defined in Article 1(2)(a) of Directive 98/5,²¹⁷¹ i.e., any persons who are nationals of a Member State and who are authorized to pursue their professional activities under one of the professional titles referred to, per Member State, in the Table set out in that provision.²¹⁷² Thus, the exception does not extend to intermediaries covered by legal professional secrecy who are not “lawyers,” such as tax consultants, accountants, notaries and auditors, for whom the requirement to notify under Article 8ab(5) of DAC 6 thus remains valid. In other words, while such intermediaries benefit from the exemption from the requirement to report directly to the tax authorities, they remain liable to inform other intermediaries.

In the Court's opinion, the “lawyer exception” is justified by the special position occupied by lawyers in the judicial organization of the Member States and to the fundamental task entrusted to them, which is recognized by all Member States. Furthermore, extending this exemption to other professionals with professional secrecy privileges would call the effectiveness of DAC6 into question. In its judgment of September 26, 2024,²¹⁷³ the CJEU added that legal advice from a lawyer enjoys, whatever the field of law to which it relates, the enhanced protection guaranteed by Article 7 of the Charter. As such, an injunction decision from a Member State ordering a lawyer to nonetheless provide information based on the DAC constitutes interference with the legal professional privilege guaranteed by that Article.

²¹⁶⁹ Charter of Fundamental Rights of the European Union, Art. 7 protects the confidentiality of all correspondence between individuals and affords strengthened protection to exchanges between lawyers and their clients.

²¹⁷⁰ Case C-623/22, *Belgian Association of Tax Lawyers and Others*.

²¹⁷¹ Directive 98/5/EC of the European Parliament and of the Council of February 16, 1998 to facilitate practice of the profession of lawyer on a permanent basis in a Member State other than that in which the qualification was obtained.

²¹⁷² Qualifying professional titles listed in the Table are, as follows – Belgium: Avocat/Advocaat/Rechtsanwalt; Bulgaria: Адвокат; Czech Republic: Advokát; Denmark: Advokat; Germany: Rechtsanwalt; Estonia: Vandeadvokaat; Greece: Δικηγόρος; Spain: Abogado/Advocat/Avogado/Abokatu; France: Avocat; Croatia: Odvjetnik/Odvjetnica; Ireland: Barrister/Solicitor; Italy: Avvocato; Cyprus: Δικηγόρος; Latvia: Zvērināts advokāts; Lithuania: Advokatas; Luxembourg: Avocat; Hungary: Ügyvéd; Malta: Avukat/Prokuratur Legali; Netherlands: Advocaat; Austria: Rechtsanwalt; Poland: Adwokat/Radca prawny; Portugal: Advogado; Romania: Avocat; Slovenia: Odvetnik/Odvetnica; Slovakia: Advokát/Komerčný právnik; Finland: Asianajaja/Advokat; Sweden: Advokat (Member States are listed as per the sequence in the Table).

²¹⁷³ Case C-432/23, *Ordre des avocats du Barreau de Luxembourg*.

3. “Cross-Border Arrangement”

A “cross-border arrangement” is defined as an arrangement or a series of arrangements in either more than one Member State or a Member State and a third country,²¹⁷⁴ where at least one of the following conditions is fulfilled: (i) not all of the participants in the arrangement or series of arrangements are resident for tax purposes in the same jurisdiction; (ii) one or more of the participants in the arrangement or series of arrangements is/are simultaneously resident for tax purposes in more than one jurisdiction; (iii) one or more of the participants in the arrangement or series of arrangements carries/carry on business in another jurisdiction through a PE situated in that jurisdiction and the arrangement or series of arrangements forms part or the whole of the business of that PE; (iv) one or more of the participants in the arrangement carries/carry on an activity in another jurisdiction without being resident for tax purposes or creating a PE situated in that jurisdiction; or (v) the arrangement or series of arrangements has a possible impact on the automatic exchange of information or the identification of beneficial ownership.

The concept of “arrangement” itself is not defined, raising the question of whether regular tax advice may be within the scope of the reporting obligation.

4. “Reportable” Cross-Border Arrangement — “Hallmarks”

A cross-border arrangement is “reportable” if it exhibits at least one of the features and elements considered to be indicators of a potential risk of tax avoidance, i.e., the “hallmarks” listed in Annex IV to DAC 6.

In selecting the hallmarks, inspiration was taken from the OECD mandatory disclosure provisions (BEPS Action 12), Member States' mandatory disclosure legislation, and other studies and reports on aggressive tax planning schemes.

Every two years after July 1, 2020, the Member States and the Commission will evaluate the relevance of Annex IV and the Commission will present a report (and, where appropriate, a legislative proposal) to the Council. Importantly, there is no *de minimis* threshold, i.e., the rules appear to apply regardless of the amounts involved (although this may possibly be dealt with by Member States when transposing the rules into their domestic laws).

Annex IV distinguishes between “generic” hallmarks (heading A) and “specific” hallmarks (headings B to E).

Hallmarks in headings A and B can only be taken into account if a “main benefit” test is also satisfied. That test will be satisfied if it can be established that the main benefit or one of the main benefits that, having regard to all relevant facts and circumstances, a person may reasonably expect to derive from an arrangement is the obtaining of a tax advantage.

Generic hallmarks (heading A) include:

- (i) An arrangement where the relevant taxpayer or a participant in the arrangement undertakes to comply with a con-

²¹⁷⁴ Purely domestic arrangements and arrangements having no link to any EU Member State thus fall outside the scope of the Directive although, of course, Member States may decide to extend their national legislation to purely domestic arrangements.

dition of confidentiality that may require the taxpayer or participant not to disclose how the arrangement could secure a tax advantage *vis-à-vis* other intermediaries or the tax authorities;

(ii) An arrangement where the intermediary is entitled to receive a fee (or interest, remuneration for finance costs and other charges) for the arrangement, the fee being fixed by reference to: (a) the amount of the tax advantage derived from the arrangement; or (b) whether a tax advantage is actually derived from the arrangement (this would include an obligation of the intermediary to refund the fees, partially or fully, where the intended tax advantage derived from the arrangement was not partially or fully achieved); and

(iii) An arrangement that has a substantially standardized documentation and/or structure and is available to more than one relevant taxpayer without having to be substantially customized for implementation.

Specific hallmarks that may be linked to the main benefit test (heading B) include:

(i) An arrangement where a participant in the arrangement takes contrived steps that consist in acquiring a loss-making company, discontinuing the main activity of the company and using its losses to reduce its tax liability, including through a transfer of those losses to another jurisdiction or by the acceleration of the use of those losses.

(ii) An arrangement that has the effect of converting income into capital, gifts or other categories of revenue that are taxed at a lower level or exempt from tax; and

(iii) An arrangement that includes circular transactions resulting in the round-tripping of funds and that works by involving interposed entities with no other primary commercial function or transactions that offset or cancel each other or that have other similar features.

Specific hallmarks related to cross-border transactions (heading C) include:

(i) An arrangement involving deductible cross-border payments made between two or more associated enterprises where at least one of the following conditions is fulfilled: (a) the recipient is not resident for tax purposes in any tax jurisdiction; (b) although the recipient is resident for tax purposes in a jurisdiction, that jurisdiction either does not impose any corporate tax, or imposes corporate tax at a zero or almost zero rate, or is included in a list of third-country jurisdictions that have been assessed by Member States collectively or within the framework of the OECD as being non-cooperative; (c) the payment benefits from a full exemption from tax in the jurisdiction in which the recipient is resident for tax purposes; or (d) the payments benefit from a preferential tax regime in the jurisdiction in which the recipient is resident for tax purposes.²¹⁷⁵

²¹⁷⁵ Unlike the Commission DAC 6 Proposal, the Directive itself does not list the presence of a “hybrid mismatch” (within the scope of ATAD 2 (see VI.B.6.)) as a specific hallmark related to cross-border transactions.

(ii) Deductions for depreciation on the same asset are claimed in more than one jurisdiction;

(iii) Relief from double taxation with respect to the same item of income or capital is claimed in more than one jurisdiction; and

(iv) An arrangement that includes transfers of assets where there is a material difference in the amount being treated as payable as consideration for the assets in the jurisdictions involved.

Specific hallmarks concerning the automatic exchange of information and beneficial ownership (heading D) relate to the automatic exchange of financial information under the CRS, as implemented in the Member States (DAC 2, see XXI.C., above) and the determination of ultimate beneficial ownership (DAC 5, see XXI.F., above). These hallmarks include:

(i) An arrangement that may have the effect of undermining the reporting obligation under the CRS. Such an arrangement includes at least the following: (a) the use of a product that is not a financial account as defined under the CRS but has features that are substantially similar to those of a financial account; (b) the transfer of financial accounts or assets to, or the use of, a jurisdiction that is required to exchange information with the jurisdiction in which the relevant taxpayer is resident; (c) the reclassification of income and capital into products that are not subject to the CRS; (d) the transfer or conversion of a financial institution or a financial account that is not defined under the CRS; (e) the use of a legal entity or an arrangement that eliminates reporting obligations with respect to an account holder or a controlling person; or (f) the use of an arrangement that undermines, or exploits weaknesses in due diligence procedures.

(ii) An arrangement involving a non-transparent legal or beneficial ownership chain using persons, legal arrangements or structures: (a) that do not carry on a substantive economic activity supported by adequate staff, equipment, assets and premises; (b) that are incorporated, managed or resident in a jurisdiction other than the jurisdiction of residence of one or more of the beneficial owners of the assets held by the persons, legal arrangements or structures; and (c) where the beneficial owners of the persons, legal arrangements or structures are unidentifiable.

Specific hallmarks concerning transfer pricing (heading E) include:

(i) An arrangement involving the use of unilateral safe harbor rules;

(ii) An arrangement involving the transfer of hard-to-value intangibles,²¹⁷⁶ and

²¹⁷⁶ The term “hard-to-value intangibles” covers intangibles or rights with respect to intangibles for which, at the time of their transfer between associated enterprises (i) no reliable comparables exist; and (ii) the projections of future cash flows or income expected to be derived from the transferred intangible, or the assumptions used in valuing the intangible, are highly uncertain, making it difficult to predict the level of ultimate success of the intangible at the time of transfer.

(iii) An arrangement involving an intra-group cross-border transfer of functions and/or risks and/or assets if the transferor's(s') projected annual earnings before interest and taxes (EBIT), during the three-year period after the transfer are less than 50% of what would have been the projected annual EBIT of the transferor's(s') had the transfer not been made.

Surprisingly, DAC 6 does not prescribe the information to be disclosed by an intermediary or a relevant taxpayer. On the other hand, the Directive requires the following information to be automatically exchanged between Member States: (i) the identities of intermediaries and relevant taxpayers (including name, date and place of birth, tax residence, tax information number and associated enterprises); (ii) details of the relevant hallmarks that make the cross-border arrangement reportable; (iii) a summary of the content of the reportable cross-border arrangement; (iv) the date of the first step in implementation; (v) details of the national provisions forming the basis of the reportable cross-border arrangement; (vi) the value of the reportable cross-border arrangement; (vii) Member States likely to be concerned with the reportable cross-border arrangement; and (viii) the identity of any other person in a Member State likely to be affected by the reportable cross-border arrangement. Since the information required to be disclosed by the intermediary or the taxpayer must facilitate the exchange of this information by the Member State concerned, one might expect the required disclosure to cover at least the names of other intermediaries, known relevant taxpayers and items (ii) to (vii) above. The Commission will not have access to the information referred to in points (i), (iii) and (viii).

5. Reporting and Reporting Period

Information must be filed with the relevant tax administration within 30 days²¹⁷⁷ from the first to occur of: (i) the day after the reportable cross-border arrangement is made available for implementation, (ii) the day after the reportable cross-border arrangement is ready for implementation, or (iii) the day when the first step in the implementation of the reportable cross-border arrangement has been taken. Intermediaries providing aid, assistance or advice must file information within 30 days beginning on the day after they provided the aid, assistance or advice. A special rule applies to reportable arrangements whose first step is implemented between June 25, 2018²¹⁷⁸ and July 1, 2020; these transactions had to be disclosed by August 31, 2020.

²¹⁷⁷ These filing periods seem considerably more lenient than those under the Commission's DAC 6 Proposal. Under the Proposal, where an intermediary was involved, disclosure had to be made before the scheme was implemented, i.e., within five days beginning on the day after the reportable arrangement had become available to the taxpayer; where the obligation was shifted to the taxpayer, disclosure had to be made within five days beginning on the day after the arrangement (or the first step in a series of reportable schemes) was implemented.

²¹⁷⁸ DAC 6 therefore has a certain retrospective element attached to it as, in principle, it is only applicable from July 1, 2020. This may be contrary to the Constitution of some Member States, such as Germany or Spain. Incidentally, France has previously attempted to introduce a mandatory disclosure obligation comparable to that adopted in DAC 6, which was found by the French courts to be unconstitutional as it infringed on the freedom of enterprise of tax advisors. Arguably, the exception for the legal professional privilege under DAC 6 may mean that this particular issue does not arise here.

Where an intermediary has to file information on a reportable cross-border arrangement with the competent authorities of more than one Member State, the information need only be filed in the Member State that features first in the following list, i.e., the Member State in which: (i) the intermediary is resident for tax purposes; (ii) the intermediary has a PE through which the services with respect to the arrangement are provided; (iii) the intermediary is incorporated or by which is governed; or (iv) the intermediary is registered with a professional association related to legal, taxation or consultancy services.

Where a relevant taxpayer has to file information on a reportable cross-border arrangement with the competent authorities of more than one Member State, the information is to be filed only with the competent authorities of the Member State that features first in the following list, i.e., the Member State in which the relevant taxpayer: (i) is resident for tax purposes; (ii) has a PE that benefits from the arrangement; (iii) receives income or generates profits, although the relevant taxpayer is not resident for tax purposes and has no PE in any Member State; (iv) carries on an activity, although the relevant taxpayer is not resident for tax purposes and has no PE in any Member State. In the case of a multiple reporting obligation, the intermediary or the relevant taxpayer, as the case may be, is exempt from filing the information if it has proof, in accordance with national law, that the same information has been filed in another Member State.

6. Exchange of Information

The disclosed information must be exchanged automatically within one month of the end of the quarter in which the information was filed (for the first time by October 31, 2020) via a central directory on administrative cooperation in the area of taxation. A standard form has been developed that requires the inclusion of the identity of the taxpayers and intermediaries involved, the hallmarks that generated the reporting obligation, and details of the arrangement and the relevant domestic tax rules.

The national tax authorities of all Member States have access to the directory. However, the exchanged information is not made available to the public and the Commission has access to it only insofar as is needed for monitoring the functioning of DAC 6.

7. Penalties

The Directive does not dictate penalties but leaves it to the Member States to implement effective, proportionate and dissuasive penalties.

8. Securing the Activity Framework of Enablers

On July 6, 2022, the Commission published a call for evidence and launched a public consultation on the policy options being considered by the Commission "to improve a regulatory framework for tax intermediaries," an initiative labelled "Securing the Activity Framework of Enablers" or "SAFE," via a legislative proposal designed to tackle the role of "enablers," i.e., intermediaries that facilitate tax evasion and aggressive tax

planning in the European Union.²¹⁷⁹ A Commission Information Note sets out the options being considered by the Commission for the proposed directive.²¹⁸⁰

Option 1 would impose a requirement on all enablers to carry out dedicated due diligence procedures. Option 2 would introduce a prohibition on facilitating tax evasion and aggressive tax planning combined with due diligence procedures and a requirement for enablers to register in the European Union. Option 3 would require enablers to follow a code of conduct obliging them to ensure that they do not facilitate tax evasion or aggressive tax planning. An additional measure (regardless of the chosen option) would require EU taxpayers (both individuals and legal persons) to declare in their annual tax returns any participation above 25% in shares, voting rights, ownership interests, bearer shareholdings or control via other means in an unlisted company located outside the European Union.

The public consultation also covers the issue of the measures potentially being considered that would ensure compliance via monetary penalties as a means of deterring the facilitation of evasion and aggressive tax avoidance and would sanction enablers, either by way of a proportion of their fees, a proportion of the amount of tax evaded or absolute fixed amounts. Other penalties being considered might include preventing an Enabler from providing any further services.

The public consultation and call for evidence ran until October 12, 2022.

It was announced that the Commission SAFE proposal would be tabled for the first quarter of 2023, after the vote on the Anti-Shell Proposal — that Proposal has, however, been withdrawn (see IX.B.5., above), which raises the question as to whether the SAFE initiative is still on the Commission's working table. In any event, the 2026 EC Working Program is silent on the SAFE initiative, but it might well be (re)captured in the context of the contemplated recast of DAC (see XXI.K., below).

H. DAC 7 — Digital Platforms

1. General

On March 22, 2021, the Council adopted Council Directive (EU) 2021/514, commonly referred to as “DAC 7.”²¹⁸¹ DAC 7 extends the scope of the automatic exchange of information under the DAC to the information reported by digital platform operators and improves a number of existing provisions of DAC 1 on the exchange of information.

DAC 7 builds on a public consultation opened on February 7, 2020 and the Commission DAC 7 Proposal that followed it on July 15, 2020 with a view to enhancing administrative cooperation between Member States' tax authorities with respect to taxpayers generating income (revenues) through digital platforms.²¹⁸² Specifically, the consultation and related Inception Impact Assessment document examined the ability of tax ad-

ministrations across the European Union to obtain tax-related information on taxpayers that generate income via the digital platform economy. The Commission stated in the Inception Impact Assessment that “Member States' tax administrations have little information to correctly assess and control gross income (revenues) earned in their country via activities (such as renting a property via a web platform or giving a ride to a person who needs a lift and/or other cases) made via the intermediation of some digital platform which basically matches demand and supply. This is especially the case when the income or the taxable amount passes via platforms established elsewhere.” The specific objective of the Commission was to update the DAC to make it possible for tax administrations to collect and then exchange taxpayer data collected by digital platform providers during the course of their operations, thus delivering a common EU reporting standard in this area. This should ensure the adequate (“fair share”) taxation of digital platform revenues while streamlining and updating the exchange of information more generally, consistent with the then ongoing work at the EU and international (for example, OECD) levels on the taxation of the digital platform economy.

Member States were to transpose DAC 7 into their national legislation on or before December 31, 2022. The DAC 7 reporting obligations apply from January 1, 2023 and the first reports had to be filed on or before January 31, 2024. Platform operators were required to put in place due diligence procedures by December 31 of the reporting period (or by December 31 of the second reporting period with respect to sellers that were already registered on January 1, 2023).

2. Digital Platforms

Under DAC 7, EU-based and, in principle, non-EU-based digital platform operators with the relevant nexus to the European Union that facilitate the offering of internal and cross-border activities are required to collect and verify information on certain users and report this information annually to the tax authorities in their Member State. This information is then shared among the Member States' national tax authorities.

Digital platforms include any software (for example, websites, applications and mobile applications) that connects sellers with potential purchasers for purposes of carrying on a “relevant activity.” Payment processing platforms and platforms that enable users to list or advertise a relevant activity and those that redirect or transfer users to another platform are excluded from the DAC 7 reporting requirements.

The term “relevant activities” refers to activities or transactions relating to the rental of commercial or residential immovable property (for example, residential, holiday and commercial properties, and parking lots), the provision of personal services (time or task-based work, such as freelance, whether on or offline), the sale of new and used goods (business-to-consumer (B2C) as well as business-to-business (B2B)), and the rental of any mode of transport (car/ridesharing, etc.).

“Reportable sellers” include individuals or entities carrying on relevant activities that are tax resident in the European Union or rent out property located in the European Union. Cer-

²¹⁷⁹ https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13488-Tax-evasion-aggressive-tax-planning-in-the-EU-tackling-the-role-of-enablers_en.

²¹⁸⁰ <https://taxation-customs.ec.europa.eu/system/files/2022-09/EC%20Discussion%20paper%20on%20SAFE%20%281%29.pdf>.

²¹⁸¹ Council Directive (EU) 2021/514 of 22 March 2021 amending Directive 2011/16/EU on administrative cooperation in the field of taxation.

²¹⁸² <https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12157-Strengthen-the-exchange-of-information-framework-in-the-field-of-taxation-public-consultation>.

tain entities are excluded from DAC 7 (for example, listed companies and related entities, government and state bodies, public authorities and casual sellers, i.e., individuals or bodies with fewer than 30 sales on the digital platform and turnover/sales of less than 2,000 euros in a given year). High-frequency property rentals exceeding certain thresholds, such as hotel chains or tour operators, are also excluded.

Reporting digital platform operators are required to register for purposes of DAC 7 in a Member State, and collect and report annually specific details on reportable sellers on their platforms. More specifically, on the one hand, platform operators are subject to due diligence obligations for the collection and verification of seller-relevant information and, on the other, need to collect and share information on transactions carried out by qualifying sellers. The due diligence requirements go beyond the standard know your customer (KYC) requirements and require the comprehensive collection and reporting of a seller's personal data to the competent authorities (including name, (primary) address, TIN, VAT identification number, date of birth/commercial register number, and the existence and location of a PE through which the activities are carried out). Depending on the specific activity of the seller, information about the object of sale or rent must also be collected (for example, in the case of the rental of immovable property, the address and land register identification of the property must be collected). In addition, the platform operator must vet the collected personal and factual information for accuracy and reliability (especially the tax numbers on the portals of the competent tax authorities).

In some instances, and with respect to certain data, a platform operator may rely on identification services made available by the relevant EU Member State. In cases where there is an element of doubt, the platform operator must obtain further documents such as a tax residency certificate or an identification document (such as an ID card or passport).

Finally, the platform operator must disclose the seller's data to the relevant tax authorities. In addition to the due diligence procedures discussed above and the information collected through its own framework, the platform operator must also collect transaction-related information (the account number, the amount of the seller's compensation paid and credited, any fees, commissions and taxes withheld or charged by the operator, the lease term in the case of immovable assets, etc.) and report such information to the tax authorities of the relevant EU Member State.

Commission Implementing Regulation (EU) 2023/823 of April 13, 2023²¹⁸³ establishes the criteria for assessing the extent to which requirements under a non-EU country's national laws for platform operator information automatically exchanged with an EU country under a competent authority agreement (CAA) are equivalent to the requirements under Annex V to DAC 1, as added by DAC 7. Specifically, the Implementing

²¹⁸³ Commission Implementing Regulation (EU) 2023/823 of 13 April 2023 laying down detailed rules for implementing certain provisions of Council Directive 2011/16/EU as regards the assessment and determination of equivalence of information in an agreement between the competent authorities of a Member State and a non-Union jurisdiction, Official Journal, April 18, 2023, OJ L 103, 18.4.2023, pp. 1–4). The Implementing Regulation entered into force on the 20th day following its publication in the OJ.

Regulation includes provisions designed to enable the assessment of the equivalence of a non-EU country's national laws with respect to: (i) the definitions of "reporting platform operator," "reportable seller" and "relevant activity;" (ii) due diligence procedures, (iii) reporting requirements; and (iv) rules and administrative procedures. Where the criteria are satisfied, the information that is required to be automatically exchanged under a CAA will be considered equivalent.

The DAC 7 regime is expected to assist tax administrations and tax authorities in the European Union by centralizing the reporting obligations of digital platform operators in one Member State and standardizing those obligations across Member States. DAC 7 also introduces new procedures for co-operation between tax authorities, in relation to enquiries, audits, etc.

DAC 7 states that penalties for violating the reporting obligations should be "effective, proportionate and dissuasive." The concrete implementation of these penalties is left to the Member State concerned. In this respect, fines are likely to be the main sanction. It should be noted that the wording of DAC 7 is identical to that of DAC 6 in this regard, undoubtedly to induce Member States to align their DAC 7 penalty provisions with those provided for with respect to DAC 6 obligations. In addition, where a seller repeatedly fails to provide a platform operator with the relevant information, the seller's account may be closed on the platform until the information has been provided.

3. Other Amendments to DAC 1

Besides the digital platform provisions discussed in XXI.H.1. and XXI.H.2., above, DAC 7 adds royalties to the categories of income subject to the automatic exchange of information. DAC 7 also enables the tax administrations of a number of Member States to carry out a joint audit in the territory of one of those Member States and to make requests for the exchange of information regarding a group of taxpayers that cannot be identified individually.

I. DAC 8 — E-Money and Crypto-Assets

1. General

On October 17, 2023, the Council adopted Council Directive (EU) 2023/2226, commonly referred to as "DAC 8."

Aside from the addition of non-custodial dividend income to the categories of income and capital already subject to the mandatory automatic exchange of information and the extension of the automatic exchange of advance cross-border rulings and APAs to high-net-worth individuals (see XXI.I.3., below), DAC 8 provides for a crypto-asset reporting framework (CARF) for competent EU authorities, intended to enter into force on January 1, 2026.

The CARF part of DAC 8 builds on a public consultation launched by the Commission on March 10, 2021. The consultation was designed to gather public opinion on the collected data and evidence required to evaluate the need for new rules on reporting and the exchange of information for tax purposes on e-money and crypto-assets, as well as on new rules on penalties and compliance measures for the various reporting obligations under the DAC framework and the potential scope of those pro-

visions.²¹⁸⁴ This resulted in a Factual Summary Report — Public Consultation on “Tax fraud & evasion — strengthening rules on administrative cooperation and expanding the exchange of information,” presented by the Commission on November 25, 2021. The Report identified as a next step the preparation of an Impact Assessment for a (possible) amendment of the DAC. The primary purpose of the amendment would be to enlarge the exchange of information framework in the field of taxation to encompass crypto-assets and e-money. The data obtained by the EU Commission through the public consultation was not only instrumental in the design of a possible DAC 8 proposal but may also prove useful for assessing the correct application of VAT legislation. On December 2022, the Commission launched its Proposal for a Council Directive amending Directive 2011/16/EU on administrative cooperation in the field of taxation,²¹⁸⁵ which was formally adopted by the Council almost one year later.

2. Crypto-Asset Reporting Framework

a. Introductory Remark

The CARF part of DAC8 is largely based on the OECD’s CARF²¹⁸⁶ and further builds on the provisions of the Regulation

²¹⁸⁴ At both the international and EU levels, a first attempt to monitor transactions involving cryptocurrencies and crypto-assets was made in the AML area. At the international level, the Financial Action Task Force (FATF), the inter-governmental body acting as the global money laundering and terrorist financing watchdog, first in 2015 and then in 2019, updated its “Guidance for a risk-based approach to virtual assets (VAs) and virtual assets service providers (VASPs)” by amending its Recommendation no. 15 and by introducing the definition of VASPs and VAs in its glossary. In this guidance, the FATF recommended adopting an approach to VAs similar to that adopted for traditional finance, such as the application of mandating know your customer (KYC)/AML laws. At the EU level, while the fifth AML Directive of May 30, 2018 does not refer to VAs but only to virtual currencies, thus focusing only on one possible type of crypto-asset, the September 24, 2020 Proposal for a Regulation on Markets in Crypto-assets, and amending Directive (EU) 2019/1937 does include a definition of a crypto-asset, which is described as “a digital representation of value or rights which may be transferred and stored electronically, using distributed ledger technology or similar technology.” See also, the EU Commission’s proposals contained in its legislative package “Anti-money laundering and countering the financing of terrorism,” published on July 20, 2021, which, *inter alia*, aligns the scope of crypto-asset service providers with that of the FATF.

²¹⁸⁵ COM (2022) 707 final; 2022/0413 (CNS); {SEC (2022) 438 final} — {SWD (2022) 400 final} — {SWD (2022) 401 final} — {SWD (2022) 402 final}.

²¹⁸⁶ In April 2021, the G20 mandated that the OECD should develop a framework providing for the automatic exchange of tax-relevant information on Crypto-Assets. In August 2022, the OECD approved the Crypto-Asset Reporting Framework (OECD CARF), which provides for the reporting of tax information on transactions in crypto-assets in a standardized manner, with a view to the automatic exchange of such information. The CARF defines the relevant in-scope crypto-assets and the intermediaries and other service providers that will be subject to reporting. In doing so, the CARF incorporates recent developments in the global AML standards of the OECD FATF. In line with the OECD Common Reporting Standard (OECD CRS), the due diligence procedures require the identification of both individual and entity customers, as well as their controlling persons. The CARF requires reporting on an aggregate basis, divided by type of crypto-asset and type of transaction. In August 2022, the OECD also approved amendments to the OECD CRS to bring certain electronic money products and Central Bank Digital currencies in scope. In light of the OECD CARF, changes have also been made to ensure that indirect investments in crypto-assets through derivatives and investment vehicles are now covered by the OECD CRS. In addition, amendments have been made to strengthen the due diligence and reporting requirements (including by requiring the reporting of the role of each controlling person) and to

on Market in Crypto-Assets (MiCA)²¹⁸⁷ and the Transfer of Funds Regulation,²¹⁸⁸ especially in its use of the definitions set out in those EU acts. DAC8 is accompanied by an Annex III (inserted as Annex VI to DAC 1), which lays down the due diligence procedures, reporting requirements and other rules that will have to be applied by the reporting crypto-asset service providers to enable Member States to communicate, by automatic exchange, the information concerned (“Annex VI”).

b. Certain Concepts Defined

DAC 8 applies to crypto-assets service providers regulated by and authorized under MiCA, as well as crypto-asset operators that, although technically out of scope of MiCA, provide crypto-asset services that are included in the scope of MiCA.

“Crypto-asset services” are defined by reference to the catalogue of services listed in Article 3(1)(9) of MiCA (itself inspired by the list of investment services in Directive 2014/65/EU of the European Parliament and of the Council of May 15, 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (MiFID II)), i.e.: (i) the custody and administration of crypto-assets on behalf of third parties; (ii) the operation of a trading platform for crypto-assets; (iii) the exchange of crypto-assets for “fiat currency”²¹⁸⁹ that is legal tender; (iv) the exchange of crypto-assets for other crypto-assets; (v) the execution of orders for crypto-assets on behalf of third parties; (vi) the placing of crypto-assets; (vii) the receipt and transmission of orders for crypto-assets on behalf of third parties; and (viii) the provision of advice on crypto-assets.²¹⁹⁰

provide a carve-out for genuine non-profit organizations. See OECD (2022), Crypto-Asset Reporting Framework and Amendments to the Common Reporting Standard, OECD, Paris, <https://www.oecd.org/tax/exchange-of-tax-information/crypto-asset-reporting-framework-and-amendments-to-the-common-reporting-standard.htm> (published October 10, 2023).

²¹⁸⁷ Regulation (EU) 2023/1114 of the European Parliament and of the Council of May 31, 2023 on markets in crypto-assets, and amending Regulations (EU) No 1093/2010 and (EU) No 1095/2010 and Directives 2013/36/EU and (EU) 2019/1937. MiCA applies from December 30, 2024, except for Titles III and IV, which apply from June 30, 2024.

²¹⁸⁸ Regulation (EU) 2015/847 of the European Parliament and of the Council of May 20, 2015 on information accompanying transfers of funds and repealing Regulation (EC) No 1781/2006 (as amended) requires payment service providers to include payer and payee information with transfers involving banknotes, coins, scriptural money and electronic money (known as the “travel rule”). On June 29, 2022, the European Parliament and Council reached a provisional agreement to extend this traceability requirement to crypto-asset transfers so as to prevent the misuse of crypto-assets to facilitate, fund and hide criminal activities and launder proceeds. The European Parliament, Council and Commission are now working on the text’s technical aspects. Once confirmed, the new regulation will be published in the EU Official Journal. Once the new rules enter into force, obliged entities will have nine months within which to perform phased rollouts to apply the travel rule. In any case, such entities will need to fully comply with the new rules 18 months after they enter into force.

²¹⁸⁹ “Fiat currency” means the official currency of a jurisdiction, issued by a jurisdiction or by a jurisdiction’s designated Central Bank or monetary authority, as represented by physical banknotes or coins or by money in different digital forms, including bank reserves or Central Bank digital currencies; the term also includes commercial bank money and electronic money products (including electronic money and e-money token) (Annex VI, Section IV.C. ad 6).

²¹⁹⁰ Crypto-asset services that “are provided in a fully decentralized manner without any intermediary” and crypto-assets without an identifiable issuer do not fall within the scope of MiCA (see MiCA, Recital 12a). MiCA thus does not capture Decentralized Finance (DeFi) and operations of Decentralized Autonomous Organizations (DAOs) — so long as control of the operations is truly

As to the term “crypto-asset” itself, DAC 8 refers²¹⁹¹ to the very broad definition in MiCA,²¹⁹² which encompasses any “digital representation of a value or a right which may be transferred and stored electronically, using distributed ledger technology (DLT)²¹⁹³ or similar technology.”²¹⁹⁴

MiCA distinguishes between three sub-categories of crypto-assets.²¹⁹⁵ The first sub-category consists of a type of crypto-asset that purports to maintain a stable value by referring to the value of several fiat currencies that are legal tender, one or several commodities or one or several crypto-assets, or a combination of such assets (“asset-referenced tokens” (ARTs)). By stabilizing their value, ARTs often aim at being used by their holders as a means of payment to buy goods and services and as a store of value. A second sub-category of crypto-assets consists of a type of crypto-asset whose main purpose is to be used as a means of exchange and that purports to maintain a stable value by referring to the value of a fiat currency that is legal tender (“electronic money tokens” or “e-money tokens” (EMTs)). The function of such crypto-assets is very similar to the function of electronic money.²¹⁹⁶ Like electronic

decentralized. DeFi represents a novel way of providing financial services that cuts out traditional centralized intermediaries and relies on automated protocols instead. In simple terms, DeFi participants are part of a peer-to-peer network (built on a public blockchain) where assets represented in the network can be transferred automatically via smart contracts (see https://www.ecb.europa.eu/pub/financial-stability/macropudential-bulletin/focus/2022/html/ecb.mp-bu202207_focus1.en.html). A DAO refers to a computer program, running on a decentralized peer-to-peer network, incorporating governance and decision-making rules, and operating autonomously, i.e. without human involvement; decisions are made from the bottom-up, governed by a community organized around a specific set of rules enforced on a blockchain.

²¹⁹¹ Annex VI, Section IV.A. ad 1.

²¹⁹² See, to that effect, MiCA, Recital (16): “Any legislative act adopted in the field of crypto-assets should be specific and future-proof, be able to keep pace with innovation and technological developments and be founded on an incentive-based approach. The terms ‘crypto-assets’ and ‘distributed ledger technology’ should therefore be defined as widely as possible to capture all types of crypto-assets that currently fall outside the scope of Union legislative acts on financial services. Any legislative act adopted in the field of crypto-assets should also contribute to the objective of combating money laundering and terrorist financing. For that reason, entities offering services falling within the scope of this Regulation should also comply with applicable anti-money laundering and counter-terrorist financing rules of the Union, which integrate international standards.” MiCA applies neither to crypto-assets captured by the existing financial services legislation (e.g., security tokens qualifying as financial instruments under MiFID II) nor to crypto-assets that are unique and not fungible with other crypto-assets, i.e., “non-fungible tokens” or “NFTs.” However, NFTs issued “in a large series or collection” may be considered fungible and therefore covered by MiCA. Fractional parts of NFTs do not fall within the exclusion.

²¹⁹³ Distributed ledger technology (DLT) means “a technology that enables the operation and use of a distributed ledger” intended as “an information repository that keeps a record of transactions and that is shared across, and synchronized between a set of DLT network nodes using a consensus mechanism;” “consensus mechanism” means the rules and procedures by which an agreement is reached, among DLT network nodes, that a transaction is validated; and “DLT network node” means a device or process that is part of a network and holds a complete or partial replica of records of all transactions on a distributed ledger (Regulation (EU) 2022/858 of the European Parliament and of the Council May 30, 2022 on a pilot regime for market infrastructures based on distributed ledger technology, Art. 2 (1) through (4) and amending Regulations (EU) No 600/2014 and (EU) No 909/2014 and Directive 2014/65/EU (the “DLT Pilot Regime Regulation”).

²¹⁹⁴ MiCA, Art. 3(1)(5).

²¹⁹⁵ See MiCA, Recital (18) and Art. 3(1)(6), (7) and (9).

²¹⁹⁶ “Electronic money” is defined as electronically, including magnetically, stored monetary value as represented by a claim on the issuer that is issued on the receipt of funds for purposes of a payment transaction (Directive 2009/

money, these crypto-assets are electronic surrogates for coins and banknotes and are used for making payments. Both ARTs and EMTs are variants of “stablecoins,” i.e. cryptocurrencies that aim to maintain a stable value relative to a specified asset or pool of assets. The third sub-category of crypto-assets is a catch-all category for all other crypto-assets that are not ARTs or EMTs; this category covers a wide variety of crypto-assets including non-pegged payment tokens (for example, cryptocurrencies such as Bitcoin or Ether) and utility tokens (the latter being defined as a type of crypto-asset intended to provide digital access to a good or service, that is available on DLT and that is only accepted by the issuer of the token).

A “reportable crypto-asset” is defined as any crypto-asset other than: (i) a Central Bank digital currency, electronic money²¹⁹⁷ or an electronic money token; or (ii) any crypto-asset that the reporting crypto-asset service provider has adequately determined cannot be used for payment or investment purposes. Based on this wording, it may be assumed that the definition of “reportable crypto-asset” can be considered a residual definition, meaning that it applies only when dealing with crypto-assets other than the above two qualitative categories. Since the “used for investment purposes” concept usually offers a certain margin of discretionary appreciation, potential loopholes might emerge under DAC8 because of the ability of reporting crypto-asset service providers to exclude certain crypto-assets from the reporting obligation any time they conclude that such crypto-assets cannot be used for investment purposes.

c. Scope

(1) Reporting Crypto-Asset Service Provider

DAC 8 applies to crypto-asset service providers regulated by and authorized under MiCA, as well as crypto-asset operators that, although technically out of scope of MiCA, provide crypto-asset services that are included in the scope of MiCA. (On the concept of “crypto-asset services,” see XXI.I.2.b., above).

More specifically, a crypto-asset service provider means any legal person or undertaking whose occupation or business is the provision of one or more crypto-asset services to third parties on a professional basis and that is authorized in a Mem-

110/EC of the European Parliament and of the Council of September 16, 2009 on the taking up, pursuit and prudential supervision of the business of electronic money institutions amending Directives 2005/60/EC and 2006/48/EC and repealing Directive 2000/46/EC (as amended), Art. 2(2)). A “payment transaction” means an act that is initiated by a payer or a payee of placing, transferring or withdrawing funds, irrespective of any underlying obligations between the payer and the payee) and is accepted by a natural or legal person other than the electronic money issuer (Directive 2007/64/EC of the European Parliament and of the Council of November 13, 2007 on payment services in the internal market amending Directives 97/7/EC, 2002/65/EC, 2005/60/EC and 2006/48/EC and repealing Directive 97/5/EC, Art. 4(5)).

²¹⁹⁷ The term “electronic money” or “e-money” does not include products created for the sole purpose of facilitating the transfer of funds from a customer to another person pursuant to the instructions of the customer. A product is not created for the sole purpose of facilitating the transfer of funds if, in the ordinary course of business of the transferring entity, either the funds connected with the product are held for more than 60 days after the receipt of instructions for facilitating the transfer, or, if no instructions are received, the funds connected with the product are held for more than 60 days after receipt of the funds.

ber State to provide crypto-asset services in accordance with MiCA.

A crypto-asset operator means any natural person, legal person or undertaking whose occupation or business is the provision of one or more crypto-asset services to third parties on a professional basis but that is not covered by the scope of MiCA (for example, a crypto-asset operator with “non-solicited” EU resident crypto-asset users or crypto-asset operators that trade non-fungible tokens) and hence do not meet the requirements for authorization under MiCA.

A reporting crypto-asset service provider is any crypto-asset service provider and any crypto-asset operator that conducts one or more crypto-asset services permitting reportable users resident in the EU to complete an exchange transaction.

A crypto-asset service provider receives authorization under MiCA in the Member State of the legal entity concerned and must report in that Member State. Such a provider is exempt from the single registration requirement applicable to crypto-asset operators; the latter are obliged to register in a Member State of their choice (single registration) and reporting is to be done in that Member State. As crypto-asset operators may be resident outside the European Union, the DAC 8 Proposal provides for relief from the single registration and reporting obligation dependent on the determination of corresponding reporting and exchange mechanisms in relation to non-EU jurisdictions and Member States. This mechanism is similar to that included in Directive 2021/514 (DAC7) and has the same purpose of ensuring a level playing field and preventing service providers from engaging in forum shopping.

(2) Reportable Transactions

Reportable transactions are exchange transactions and transfers of reportable crypto-assets. The term “exchange transaction” means: (i) any exchange between reportable crypto-assets and fiat currencies; and (ii) any exchange between one or more reportable crypto-assets. “Transfer” means a transaction that moves a reportable crypto-asset from or to the crypto-asset address or account of a crypto-asset user, other than one maintained by the reporting crypto-asset service provider on behalf of the same crypto-asset user, where, based on the knowledge available to the reporting crypto-asset service provider at the time of transaction, the reporting crypto-asset service provider cannot determine that the transaction is an “exchange transaction” (Annex VI, Section IV.C. *ad* 1, 2 and 5).

Although this is not explicitly stated in DAC 8, both domestic and cross-border transactions are within the scope of DAC 8 (see, to that effect, the Explanatory Memorandum of the DAC 8 Commission proposal) and are aggregated by type of reportable crypto-assets. The European Union does not deviate from the OECD CARF in this respect.

(3) Reportable User

A crypto-asset user is an individual or entity that is a customer of a reporting crypto-asset service provider for purposes of carrying out reportable transactions. An individual or entity, other than a financial institution or a reporting crypto-asset service provider, acting as a crypto-asset user for the benefit or account of another individual or entity as agent, custodian, nominee, signatory, investment adviser or intermediary, is not

treated as a crypto-asset user; the other individual or entity is treated as the crypto-asset user.

Where a reporting crypto-asset service provider facilitates payments in crypto-assets for or on behalf of a merchant, the customer that is the counterparty to the merchant must be treated as a crypto-asset user. In such cases, the reporting crypto-asset service provider is required to verify the identity of the customer in line with domestic AML rules.

A reportable user is a crypto-asset user resident in a Member State that is a reportable person. Excluded persons are: (i) an entity whose stock is regularly traded on one or more established securities markets; (ii) an entity that is a related entity of an entity described in (i); (iii) a governmental entity; (iv) an international organization; (v) a central bank; and (vi) a financial institution other than an investment entity (broadly, meaning an entity that invests on behalf of its customers, for example, an entity that trades in money market instruments, engages in individual or collective portfolio management, or otherwise invests or administers financial assets for its customers.)²¹⁹⁸

A crypto-asset user is treated as a reportable user beginning from the date on which it is identified as such under the due diligence procedures described in Section III of Annex VI (see XXI.I.2.d.(2), below).

Only the transactions of a reportable user are reportable.

d. Obligations of Reporting Crypto-Asset Service Providers — Self-Certification

(1) General

Detailed rules concerning the obligations to be fulfilled by reporting crypto-assets service providers are laid down in Annex VI.

As a first step, the rules establish an obligation for the reporting crypto-asset service provider to collect and verify the information in line with due diligence procedures laid down by DAC 8.

As a second step, the reporting crypto-asset service provider must report information on the crypto-asset users to the relevant competent authority.

The third step concerns the communication of the reported information by the competent authority of the Member State that has received the information from the reporting crypto-asset service provider to the competent authority of the relevant Member State in which the reportable crypto-asset user is resident (see XXI.I.2.e., below).

(2) Due Diligence Procedures

A reporting crypto-asset service provider is obliged to carry out the due diligence procedures laid down in Section III of

²¹⁹⁸ Specifically, the investment entities targeted are entities whose gross income is primarily attributable to investing, reinvesting or trading in financial assets or reportable crypto-assets and that are managed by other entities that are depository institutions, custodial institutions, specified insurance companies or investment entities that primarily conduct as a business one or more of the following activities or operations for or on behalf of customers: (i) trading in money market instruments (cheques, bills, certificates of deposit, derivatives, etc.), foreign exchange, exchange, interest rate and index instruments, transferable securities or commodities futures; (ii) individual and collective portfolio management; or (iii) otherwise investing, administering or managing financial assets, money or reportable crypto-assets.

Annex VI to identify reportable users. The identification of reportable users is achieved via self-certification. If a crypto-asset user does not provide the information required under Section III after two reminders following the initial request made by the reporting crypto-asset service provider, but not prior to the expiration of 60 days, the reporting crypto-asset service provider must prevent the crypto-asset user from performing exchange transactions.

Section III of Annex VI distinguishes between due diligence procedures for individual crypto-asset users and due diligence procedures for entity crypto-asset users:

(i) As regards individual crypto-asset users: when establishing the relationship with an individual crypto-asset user, the reporting crypto-asset service provider must obtain a self-certification that allows the crypto-asset service provider to determine the individual crypto-asset user's residence(s) for tax purposes and confirm the reasonableness of the self-certification based on the information obtained by the reporting crypto-asset service provider. This includes any documentation collected under the customer due diligence procedures of a reporting crypto-asset service provider under Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, and amending Directive 2009/138/EC and Directive 2013/36/EU (the "Anti-money Laundering Directive"), as amended by Directive (EU) 2018/843 of the European Parliament and of the Council of May 30, 2018 or similar requirements to which the reporting crypto-asset service provider may be subject.

If at any point there is a change of circumstances with respect to an individual crypto-asset user that causes the reporting crypto-asset service provider to know, or have reason to know, that the original self-certification is incorrect or unreliable, the reporting crypto-asset service provider cannot rely on the original self-certification and is obliged to obtain a valid self-certification, or a reasonable explanation and, where appropriate, documentation supporting the validity of the original self-certification.

The same procedures apply with respect to pre-existing individual crypto-asset users, i.e., individual crypto-asset users who have established a relationship with the reporting crypto-asset service provider as of December 31, 2025.

(ii) As regards entity crypto-asset users: when establishing the relationship with an entity crypto-asset user, the reporting crypto-asset service provider must obtain a self-certification that allows the reporting crypto-asset service provider to determine the entity crypto-asset user's residence(s) for tax purposes and confirm the reasonableness of the self-certification based on the information obtained by the reporting crypto-asset service provider, including any documentation collected under the due diligence conducted.

If the entity crypto-asset user certifies that it has no residence for tax purposes, the reporting crypto-asset service provider may rely on the place of effective management or the address of the principal office to determine the residence of the entity crypto-asset user.

The reporting crypto-asset service provider must determine whether an entity crypto-asset user (other than an "excluded person" within the meaning of Section IV.E. of Annex VI) has one or more "controlling persons"²¹⁹⁹ who are reportable persons unless it determines that the entity crypto-asset user is an "Active Entity" within the meaning of point 10 of Section IV.D. of Annex VI,²²⁰⁰ based on a self-certification from the entity crypto-asset user. For purposes of determining the "controlling persons" of the entity crypto-asset user, a reporting crypto-asset service provider may rely on information collected and maintained under the customer due diligence procedures of a reporting crypto-asset service provider under the Anti-money Laundering Directive or similar requirements to which the reporting crypto-asset service provider is subject. A reporting

²¹⁹⁹ "Controlling persons" means the natural persons who exercise control over an entity. In the case of a trust, this means the settlor(s), the trustee(s), the protector(s) (if any), the beneficiary(ies) or class(es) of beneficiaries, and any other natural person(s) exercising ultimate effective control over the trust and, in the case of a legal arrangement other than a trust, it means persons in equivalent or similar positions. The term "controlling persons" is to be interpreted in a manner consistent with the term "beneficial owner" as defined in the Directive (EU) 2015/849 pertaining to Crypto-Asset Service Providers (Annex VI, Section IV.D. *ad* 9).

²²⁰⁰ Annex VI, Section IV.D., Point 10 defines an "active entity" as any entity that satisfies any of the following criteria: (i) less than 50% of the entity's gross income for the preceding calendar year or other appropriate reporting period is passive income and less than 50% of the assets held by the entity during the preceding calendar year or other appropriate reporting period are assets that produce, or are held for the production of, passive income; (ii) substantially all of the activities of the entity consist of holding (in whole or in part) the outstanding stock of, or providing financing and services to, one or more subsidiaries that engage in trades or businesses other than the business of a financial institution, except that an entity does not qualify for this status if the entity functions (or holds itself out) as an investment fund, such as a private equity fund, venture capital fund, leveraged buyout fund or any investment vehicle whose purpose is to acquire or fund companies and then hold interests in those companies as capital assets for investment purposes; (iii) the entity is not yet operating a business and has no prior operating history but is investing capital into assets with the intention of operating a business other than that of a financial institution, provided the entity does not qualify for this exception after 24 months after the date of the initial organization of the entity; (iv) the entity has not been a financial institution in the past five years and is in the process of liquidating its assets or is reorganizing with the intention of continuing or recommencing operations in a business other than that of a financial institution; (v) the entity primarily engages in financing and hedging transactions with, or for, related entities that are not financial institutions, and does not provide financing or hedging services to any entity that is not a related entity, provided the group of any such related entities is primarily engaged in a business other than that of a financial institution; or (vi) the entity meets all of the following requirements: (a) it is established and operated in its jurisdiction of residence exclusively for religious, charitable, scientific, artistic, cultural, athletic or educational purposes; or it is established and operated in its jurisdiction of residence and is a professional organization, business league, chamber of commerce, labor organization, agricultural or horticultural organization or civic league, or an organization operated exclusively to promote social welfare; (b) it is exempt from income tax in its jurisdiction of residence; (c) it has no shareholders or members that have a proprietary or beneficial interest in its income or assets; (d) the applicable laws of the entity's jurisdiction of residence or the entity's formation documents do not permit any income or assets of the entity to be distributed to, or applied for the benefit of, a private person or non-charitable entity other than pursuant to the conduct of the entity's charitable activities, as payment of reasonable compensation for services rendered, or as payment representing the fair market value of property that the entity has purchased; and (e) the applicable laws of the entity's jurisdiction of residence or the entity's formation documents require that, on the entity's liquidation or dissolution, all of its assets be distributed to a governmental entity or other non-profit organization, or escheat to the government of the entity's jurisdiction of residence or any of its political subdivisions. For purposes of this definition, a "financial institution" means a custodial institution, a depository institution, an investment entity or a specified insurance company.

crypto-asset service provider that is not legally required to apply customer due diligence procedures that are consistent with the Anti-money Laundering Directive must apply substantially similar procedures for purposes of determining the controlling persons. For purposes of determining whether a “controlling person” is a reportable person, a reporting crypto-asset service provider must rely on a self-certification from the entity crypto-asset user or the “controlling person” that allows the reporting crypto-asset service provider to determine the controlling person’s residence(s) for tax purposes and confirm the reasonableness of the self-certification based on the information obtained by the reporting crypto-asset service provider. This includes any documentation collected under customer due diligence procedures of a reporting crypto-asset service provider under the Anti-money Laundering Directive or similar requirements to which the reporting crypto-asset service provider is subject.

If, at any point, there is a change in circumstances with respect to an entity crypto-asset user or its “controlling persons” that causes the reporting crypto-asset service provider to know, or have reason to know, that the original self-certification is incorrect or unreliable, the reporting crypto-asset service provider cannot rely on the original self-certification and must obtain a valid self-certification, or a reasonable explanation and, where appropriate, documentation supporting the validity of the original self-certification.

The same procedures apply with respect to pre-existing entity crypto-asset users, i.e., entity crypto-asset users that have established a relationship with the reporting crypto-asset service provider as of December 31, 2025.

(3) Requirements for Validity of Self-Certifications

A self-certification provided by an individual crypto-asset user or “controlling person” is valid only if it is signed or otherwise positively affirmed by the individual crypto-asset user or “controlling person,” it is dated at the latest on the date of receipt and it contains the following information with respect to the individual crypto-asset user or “controlling person:”

- (i) First and last name;
- (ii) Residential address;
- (iii) Member State(s) of residence for tax purposes;
- (iv) With respect to each reportable person, the TIN²²⁰¹ (or functional equivalent in the absence of a TIN) for each Member State; and
- (v) Date of birth.

A self-certification provided by an entity crypto-asset user is valid only if it is signed or otherwise positively affirmed by the entity crypto-asset user, it is dated at the latest on the date of receipt and it contains the following information with respect to the entity crypto-asset user:

- (i) Legal name;
- (ii) Address;
- (iii) Member State(s) of residence for tax purposes; and

- (iv) With respect to each reportable person, the TIN for each Member State.

In the case of a “controlling person,” the self-certification must contain a description of the role(s) by virtue of which each reportable user is a “controlling person of the entity, if not already determined based on customer due diligence procedures.

The reporting crypto-asset service provider is not required to collect information other than the first and last name (in the case of an individual crypto-asset user or a “controlling person”) or the legal name (in the case of an entity crypto-asset user) where it relies on the self-certification of the crypto-asset user through an identification service made available by a Member State or the European Union to ascertain the identity and tax residence of the crypto-asset user; if the reporting platform operator relied on an identification service to ascertain the identity and tax residence of a reportable crypto-asset user, the name, identification service identifier and Member State of issuance will be required.

(4) Reporting

The requisite information on a reportable transaction, as collected and verified, is to be reported by the reporting crypto-asset service provider no later than January 31 of the year following the relevant calendar year or other appropriate reporting period to the competent tax authorities of the Member State in which the reporting crypto-asset service provider is authorized under MiCA or, if it is not authorized under MiCA, to the competent tax authorities of the Member State in which the reporting crypto-asset service provider is registered.²²⁰²

The reporting crypto-asset service provider must inform each individual concerned that information relating to the individual will be collected and reported to the competent authorities, at the latest before the information is reported. The reporting crypto-asset service provider must also provide all information data controllers are required to provide under the General Data Protection Regulation (GDPR) legislation. The reporting crypto-asset service provider has to supply each individual with all the relevant information, at the latest before the information is reported. This is without prejudice to the data subject’s rights provided for under the GDPR.

e. Mandatory Automatic Exchange of Information Between Competent Authorities

The reported information is to be communicated, by means of automatic exchange, by the Member State’s competent authority that receives the information from the reporting crypto-asset service provider to the competent authority of the Member State in which the reportable user is tax resident. This communication is to be made within two months following the end of the calendar year to which the reporting requirements applicable to reporting crypto-asset service providers relate. The first information is to be communicated for the relevant calendar year or other appropriate reporting period with effect from January 1, 2027.

The automatic exchange of information will take place electronically via the EU CCN, using an XML schema developed by the Commission. This is the CCN used for the auto-

²²⁰¹ The TIN is any number or code that a competent authority uses to identify a taxpayer.

²²⁰² Annex VI, Section A.

matic exchange of information on advance cross-border tax rulings and cross-border arrangements.

The following information on reportable users will be exchanged:

- (i) Legal name;
- (ii) Legal address;
- (iii) Member State of residency;
- (iv) TIN (if applicable); and
- (v) Place of birth (in the case of an individual).

The same information concerning reporting crypto-asset service providers will also be exchanged, as well as the individual identification number and global legal entity identifier, a code that provides unique identification information on legal entities that participate in financial transactions globally.

For each reportable crypto-asset, information will be exchanged if a reportable transaction occurs during the relevant reporting period. The reported information consists of:

- (i) The full name of the type of asset;
- (ii) The gross amount paid and received;
- (iii) The fair market value of the asset; and
- (iv) The number of units of the transactions.

Reports are to be filed on an aggregated basis.

f. Penalties

Member States must lay down rules on penalties applicable to infringements of national provisions adopted under DAC 8 that are to be effective, proportionate and dissuasive. A minimum financial penalty is to apply in the case of non-reporting after two valid administrative reminders or when the information provided contains incomplete, incorrect or false data, amounting to more than 25% of the information that should have been reported.

Member States are to ensure that the penalties that can be applied include at least the minimum pecuniary penalties set out in Article 1(13) of DAC 8. As a ground rule, for example, in the case of non-compliance with national provisions adopted to comply with DAC 8, the minimum pecuniary penalty is to be no less than 50,000 euros (scaled on the annual turnover of the relevant taxpayer; for example, the minimum penalty increases to 150,000 euros when revenue exceeds 6 million euros).

g. Date of Application of DAC 8

DAC 8 is to apply from January 1, 2026. Member States must adopt and publish the laws, regulations and administrative provisions necessary to comply with DAC 8 by December 31, 2025 at the latest.

Technical working groups are currently developing the specifications for eTRCs, the CFI portal and reporting interfaces. Seven implementing regulations are expected in early 2026 to address these technical details and promote uniform interpretation.

Note: It has been speculated that a FASTER 2 and a FASTER 3 may be developed to address unresolved issues,

such as the definition of beneficial ownership and the extension of mandatory procedures.

3. Other Amendments to DAC 1

DAC 8 adds non-custodial dividend income to the categories of income and capital already subject to the mandatory automatic exchange of information (see XXI.B.4.b., above). “Non-custodial dividend income” refers to dividends or other income treated as dividends in the payer’s Member State that are paid or credited to an account other than a custodial account (as defined in Section VIII.C. *ad* 3 of Annex I). DAC 8 also extends the automatic exchange of advance cross-border rulings and APAs to encompass high-net-worth individuals (see XXI.D.3., above).

J. DAC 9 – Pillar Two

On October 28, 2024, the Commission launched a proposal for a DAC 9 aimed at facilitating the filing and exchanging of Pillar Two related information in the European Union (for a discussion of the Pillar Two Directive, see VII., above).²²⁰³ The proposal was formally adopted on April 14, 2025 as Council Directive (EU) 2025/872 amending Directive 2011/16/EU on administrative cooperation in the field of taxation.

DAC 9 builds on Article 44 of the Pillar Two Directive, which sets out the filing requirements that must be met by entities within scope of the Directive. Article 44 refers to a Top-up tax information return, which must be filed using a standard template and includes certain specified data points. The Top-up tax information return is a risk-assessment tool: it contains the information a tax administration needs to perform an appropriate risk assessment and evaluate an entity’s tax liability correctly.

The baseline scenario for filing under Article 44(2) of the Pillar Two Directive is that each constituent entity must file its Top-up tax information return in the Member State in which it is located. This means that each constituent entity of an MNE would need to file with its tax administration very extensive reports that would also include high-level information from the MNE to which it belongs. However, Article 44(3) provides for a derogation from this local filing requirement to the extent the UPE (or a designated filing entity) files the Top-up tax information return on behalf of the entire MNE. The only condition attached is that arrangements for exchanging information between tax administrations must be in place between the jurisdictions involved (i.e., the jurisdiction of the UPE or the designated filing entity and the jurisdictions of the other constituent entities in the group in question). Under these arrangements there is only one report for the whole MNE, and the constituent entities are then exempted from filing reports themselves locally. It is expected that most MNEs will opt for general reporting by an entity designated for the entire group to report the information required by the Pillar Two Directive.

²²⁰³ COM (2024) 497 final; 2024/0276(CNS).

Mirroring the OECD approach, which has developed a standard template (the “GloBE Information Return” or GIR) to be used by the entities to comply with their filing obligations that contains the data points to be exchanged, as well as explanatory guidance on its use, DAC 9 aims to transpose the GIR into EU law by making it the Top-up tax information return (TTIR) envisaged in Article 44 of the Pillar Two Directive.

DAC 9 also lays down a framework designed to facilitate the exchange of TTIRs between Member States and enable MNEs to switch from local to central filing (i.e., filing by the UPE or a designated filing entity instead of filing by each constituent entity). This framework includes a “dissemination approach” to ensure that all relevant jurisdictions receive the information they need, based on their role in relation to an MNE, in line with the OECD framework.

Member States will have to sign appropriate international agreements for the exchange of information with third country jurisdictions. To ensure the smooth functioning of the information exchange and to minimize the administrative burden, the proposed rules applicable within the European Union are fully compatible with the rules governing the exchange of information exchange with third country jurisdictions.

The Annex attached to DAC 9 consists of three sections. The first section defines certain terms used in the Annex and the relevant Articles in the DAC. The second section describes the filing rules that apply to the filing entity of an MNE. The third section includes the TTIR (which is fully in line with the GIR developed by the OECD) and aligns it with the Pillar Two Directive.

DAC 9 will enter into force on the day following that of its publication in the Official Journal. Member states have to implement DAC 9 by December 31, 2025. Countries opting to delay the implementation of the Pillar Two Directive are still required to transpose DAC 9 by the same deadline.

Noteworthy, the provision included in the initial DAC 9 Commission Proposal empowering the EU Commission to adopt delegated acts in respect to any future amendments to be introduced to the standard form of the TTIR was abandoned in the final text due to lack of unanimity among the Member States on this point.

Thus, any future amendment of the standard form of the TTIR will require an EU Council Directive (adopted at the unanimity of the EU Member States, as per Article 113 of the TFEU under the special legislative procedure). In a Statement of March 10, 2025 addressed to the EU Council, the EU Commission emphasized the need to ensure that the standard template for reporting set out in Section IV of Annex VII of DAC 9 remains closely aligned with the GIR so as to minimize the burden on businesses and tax administrations alike. The Commission added that it will, if appropriate, table any necessary legislative proposals to amend Section IV of Annex VII, in an expedited manner, to ensure alignment with relevant international developments.

DAC 9 is supplemented by Commission Implementing Regulation (EU) 2025/1325 of July 7, 2025, which amended Implementing Regulation (EU) 2015/2378. The amendment specifically concerns the standard forms and computerized formats to be used for the mandatory automatic exchange of information (under Council Directive 2011/16/EU as amended by

Council Directive (EU) 2025/872). The regulation includes the following measures:

- (i) The establishment of a standardized digital format for the mandatory Automatic Exchange of Information (AEOI) reported by multinational enterprise (MNE) groups and large-scale domestic groups under DAC 9, in accordance with the OECD Pillar Two initiative; and
- (ii) The introduction of a common information technology (IT) schema in line with OECD standards to ensure taxpayer compliance with Pillar Two and to minimize administrative compliance costs. The regulation specifies the XML Schema format for mandatory information exchange under the Pillar Two Directive (added as Annex XVII). This took effect on August 6, 2025.

K. Future Prospects — DAC Recast

In the wake of its second evaluation on DAC,²²⁰⁴ the EU Commission is currently preparing a recast of DAC intended to consolidate and merge all DAC iterations (i.e., DACs 1 through 9) into a single legislative instrument, with Q2 of 2026 as the (indicative) timetable (the “DAC recast”). The consolidation should remove complexities from the existing layered amendments (to DAC 1) with a view to improving legal clarity and reducing divergent national interpretations, most notably in relation to DAC 6 (Intermediaries/Cross-Border Arrangements), DAC 7 (Digital Platforms), and the interaction between DAC 4 (Country-by-Country reporting) and DAC 9 (Pillar Two reporting).

Within the context of the DAC recast, DAC 6 would be (partially) reformed, namely by:

- Addressing the high volume of over-reporting, particularly regarding A3 hallmarks, which focus on standardized documentation;²²⁰⁵
- Extending reporting deadlines from 30 to 90 days;
- Shifting towards taxpayer-only reporting to reduce duplicative intermediary reporting;
- Clarifying definitions and strengthening proportionality safeguards.

In addition, the DAC recast would include an alignment of reporting frameworks by merging DAC 4 and DAC 9 with a view to eliminating duplication and implementing a centralized group reporting model.

The DAC recast should also ensure stronger protections for confidential advisory relationships and codify taxpayer rights recognized by CJEU case law.

²²⁰⁴ Report from the Commission to the European Parliament and the Council on the evaluation of Council Directive 2011/16/EU on administrative co-operation in the field of taxation, November 19, 2025, COM (2025) 695 final, {SWD (2025) 365 final} (https://taxation-customs.ec.europa.eu/document/download/c24ef108-3dce-4169-84e3-0d024f419efd_en?file-name=COM_2025_695_1_EN_ACT_part1_v3.pdf). A Call for Evidence and a Public Consultation on the possible DAC recast were initiated by the EU Commission on December 16, 2025, and ended on February 10, 2026.

²²⁰⁵ In the Commission’s November 2025 evaluation, the Main Benefit Test (MBT) and hallmarks A1, A2 and A3 under DAC 6 are reported to create significant administrative burden, partly because they are applied inconsistently across Member States.

The FASTER Directive (see VIII., above) would be used to streamline withholding tax relief and to improve digital data exchange.

Integration of anti-abuse measures from, for example, the (withdrawn) Anti-Shell Proposal (see IX.B.5., above) is anticipated to strengthen the reporting framework.

Finally, efforts would focus on harmonizing penalty frameworks and developing a European tax identification number (TIN) to improve data matching efficiency across Member States.

XXII. Non-Cooperative Jurisdictions for Tax Purposes

A. General

Executive Summary

After describing the genesis and methodology of what have become known as the “black and grey lists of non-cooperative jurisdictions” (including the implications of figuring on those lists) (XXII.A. and XXII.B., below), this Section sets out a chronological overview of the evolution of those lists (XXII.C., below).

In its January 28, 2016 Communication on an External Strategy for Effective Taxation²²⁰⁶ forming part of the Commission’s 2016 Anti-Tax Avoidance Package, the Commission announced that it would undertake work towards the development of a common EU system for assessing, screening and listing third countries that failed to comply with tax good governance standards, along with a unified EU response to these jurisdictions.

To achieve this, the Communication set out a three-step process, i.e.:

(i) Identification of third countries that should be prioritized for screening by the European Union based on a scoreboard of indicators, including:

- (a) Economic ties with the European Union;
- (b) The level of financial activity;
- (c) Institutional factors; and
- (d) Legal factors,

to determine the potential impact of jurisdictions on Member States’ tax bases (“scoreboard approach;”)

(ii) Decision by Member States on which jurisdictions should be assessed against the European Union’s tax good governance criteria, the assessment of the selected third countries’ tax systems being carried out by the Code of Conduct for Business Taxation Group (see XV., above) in consultation with the Commission (“assessment or screening phase;”) and

(iii) Decision by Member States in Council, at the recommendation of the Commission, as to whether to add a jurisdiction to a common EU list of problematic tax jurisdictions (“non-cooperative jurisdictions.”)

In September 2016, the Commission presented the scoreboard of its pre-assessment of all third country jurisdictions for tax purposes. In November 2016, the Council set out the screening process criteria, i.e.:

- (i) The compliance of jurisdictions in relation to tax transparency; and
- (ii) Fair taxation and the implementation of anti-base erosion and profit-shifting (BEPS) measures.

The above criteria were to be assessed cumulatively in the screening process, being adjusted by the Council, as necessary, having regard to:

- (i) The evolution of international standards;
- (ii) Future ratings of those standards; and
- (iii) The importance of all relevant jurisdictions making continuing and rapid progress in these areas (the “Criteria.”)

In February 2017, letters were sent to 92 jurisdictions to inform them that they would be subject to “screening” with a view to assessing their tax systems. These were the 92 jurisdictions that were included in the Commission’s scoreboard of indicators tables I and II (including countries such as Canada, Korea (ROK), Switzerland and the United States).

Screening was due to be completed by September 2017, with the next objective being for the Council to endorse the list of non-cooperative jurisdictions by the end of 2017. This was achieved by the adoption of the Council Conclusions on the EU list of non-cooperative jurisdictions for tax purposes (the “Council Conclusions,”) published on December 19, 2017 in the Official Journal.²²⁰⁷ See further, below.

B. Annexes to Council Conclusions

ANNEX I, the so-called “black list,” details the non-cooperative jurisdictions for tax purposes. Besides potential regulatory, anti-money laundering (AML), corporate, or banking consequences, inclusion on the ANNEX I list may have a broad range of tax ramifications such as, depending on the tax legislation of the Member State concerned:

- (i) The non-deductibility of costs;
- (ii) The application of CFC rules;
- (iii) The withholding tax measures;
- (iv) The limitation of participation exemption;
- (v) The application of the switch-over rule (from exemption method to credit method);
- (vi) The reversal of the burden of proof;
- (vii) Special documentation requirements; and
- (viii) Mandatory disclosure by tax intermediaries of specific schemes with respect to cross-border arrangements (see “Intermediaries” Directive or DAC 6 discussed at XXI.G., above).

From 2024, inclusion on the black list is also relevant to EU public CbCR obligations as these require country-by-country information to be separately reported for each jurisdiction on the black list and for each jurisdiction that has been on the grey list for a minimum of two years (see DAC 4 discussed at XXI.E., above).

Non-cooperative jurisdictions are also targeted by the FASTER Proposal (see VIII., above).

Finally, Commission Recommendation of July 14, 2020²²⁰⁸ makes the provision of State financial support to undertakings

²²⁰⁶ COM (2016) 24 final.

²²⁰⁷ (2017/C 438/04), OJ C 438 of December 19, 2017.

²²⁰⁸ C (2020) 4885 final; see XVI.H., above.

in the EU conditional on the absence of links to non-cooperative jurisdictions.

ANNEX II, the “grey list,” reflects the state of play of the cooperation with the EU with respect to commitments taken by cooperative jurisdictions to implement tax good governance principles.

ANNEX III — According to the Council Conclusions, the placing of a jurisdiction on the list of non-cooperative jurisdictions for tax purposes is expected to have a dissuasive effect that will encourage jurisdictions to comply with the Criteria and other relevant international standards.

It is, therefore, important to provide efficient protection mechanisms to fight against the erosion of Member States’ tax bases through:

- (i) Tax fraud;
- (ii) Tax evasion; and
- (iii) Tax avoidance,

and, consequently, to apply effective and proportionate defensive measures, at the EU and national levels, to the jurisdictions on the EU list of non-cooperative jurisdictions for tax purposes.

The lists of both nontax and tax defensive measures are set out in ANNEX III. Implementation is left to the competence of the Member States.

Defensive measures in the tax area (Part B of ANNEX III) include:

- (i) Non-deductibility of costs;
- (ii) Controlled foreign company (CFC) rules;
- (iii) Withholding tax measures;
- (iv) Limitations on the participation exemption;
- (v) A switch-over rule;
- (vi) Reversal of the burden of proof; and
- (vii) Special documentation requirements.

ANNEX IV specifies guidelines for further progress concerning the EU list of non-cooperative jurisdictions for tax purposes.

ANNEX V reiterates the criteria that Member States undertake to promote (some of these are described further in ANNEXES VI and VII).

C. Evolution of the List of Non-Cooperative Jurisdictions (ANNEX I and ANNEX II)

The list of non-cooperative jurisdictions for tax purposes or ANNEX I had to be revised by the Council at least once a year and endorsed based on the report from the Code of Conduct Group on Business Taxation to the Council, indicating the starting date of application of a modification. Decisions of the Council are based on reports of the Code of Conduct Group, in coordination with the High-Level Working Party on Tax Questions (HLWP), prepared by the Committee of Permanent Representatives.

On October 10, 2019, the Council requested a more stable review and more frequent updating of the list from 2020 onwards, i.e., two updates per year.

The first version of ANNEX I (December 2017) listed the following jurisdictions as non-cooperative jurisdictions for tax purposes:

- (i) American Samoa;
- (ii) Bahrain;
- (iii) Barbados;
- (iv) Grenada;
- (v) Guam;
- (vi) Korea (ROK);
- (vii) Macao SAR;
- (viii) Marshall Islands;
- (ix) Mongolia;
- (x) Namibia;
- (xi) Palau;
- (xii) Panama;
- (xiii) Saint Lucia;
- (xiv) Samoa;
- (xv) Trinidad and Tobago;
- (xvi) Tunisia; and
- (xvii) The United Arab Emirates.

On January 23, 2018, eight jurisdictions were removed from ANNEX I following commitments made at a high political level to remedy EU concerns by:

- (i) Barbados;
- (ii) Grenada;
- (iii) Korea (ROK);
- (iv) Macao SAR;
- (v) Mongolia;
- (vi) Panama;
- (vii) Tunisia; and
- (viii) The United Arab Emirates.

These jurisdictions were moved to ANNEX II.

On March 13, 2018, the Council removed the following from ANNEX I:

- (i) Bahrain;
- (ii) The Marshall Islands; and
- (iii) Saint Lucia;

but added:

- (i) The Bahamas;
- (ii) Saint Kitts and Nevis; and
- (iii) The US Virgin Islands.

On May 25, 2018, the following jurisdictions were removed from ANNEX I:

- (i) The Bahamas; and
- (ii) Saint Kitts and Nevis.

On October 2, 2018, the Council removed Palau from ANNEX I.

On November 6, 2018, Namibia was removed from ANNEX I and moved to ANNEX II.²²⁰⁹ As a result, the list was down to five non-cooperative jurisdictions, i.e.;

- (i) American Samoa;
- (ii) Guam;
- (iii) Samoa;
- (iv) Trinidad and Tobago; and
- (v) The US Virgin Islands.

65 jurisdictions were considered to be actively cooperating with the EU in implementing tax good governance standards.

On March 12, 2019, the following 10 jurisdictions were (again) added to ANNEX I:

- (i) Aruba;
- (ii) Barbados;
- (iii) Belize;
- (iv) Bermuda;
- (v) Dominica;
- (vi) Fiji;
- (vii) Marshall Islands;
- (viii) Oman;
- (ix) The United Arab Emirates; and
- (x) Vanuatu.

On May 17, 2019, the following countries were removed from ANNEX I:

- (i) Aruba;
- (ii) Barbados; and
- (iii) Bermuda.

On June 14, 2019, Dominica was removed from ANNEX I.

On October 10, 2019, the Council agreed to remove the Marshall Islands and the United Arab Emirates from ANNEX I.

On February 18, 2020, the following jurisdictions were (re-)added to ANNEX I;

- (i) Cayman Islands;
- (ii) Palau;
- (iii) Panama; and
- (iv) The Seychelles.

Sixteen other jurisdictions, including, notably, the British Virgin Islands, were under formal scrutiny but deemed to have implemented the rules to comply with EU tax good governance principles and were therefore not added to the list.

On October 5, 2021, the following countries were removed from ANNEX I and included in ANNEX II:

- (i) Anguilla;
- (ii) Dominica; and
- (iii) The Seychelles.

Following the EU Council's meeting of February 24, 2022, no changes were made to ANNEX I.

On October 4, 2022, the following jurisdictions were (re)added to ANNEX I:

- (i) Anguilla;
 - (ii) The Bahamas; and
 - (iii) The Turks and Caicos Islands.
- On February 14, 2023, the Council added to ANNEX I:
- (i) The British Virgin Islands;
 - (ii) Costa Rica;
 - (iii) The Marshall Islands; and
 - (iv) Russia.

On October 17, 2023, Costa Rica and Marshall Islands were removed from ANNEX I, while the following jurisdictions were added:

- (i) Antigua and Barbuda;
- (ii) Belize; and
- (iii) The Seychelle.

Following this update, 16 jurisdictions are currently on the list of non-cooperative jurisdictions, i.e.:

- (i) American Samoa;
- (ii) Anguilla;
- (iii) Antigua and Barbuda;
- (iv) The Bahamas;
- (v) Belize;
- (vi) Fiji;
- (vii) Guam;
- (viii) Palau;
- (ix) Panama;
- (x) Russia;
- (xi) Samoa;
- (xii) The Seychelles;
- (xiii) Trinidad and Tobago;
- (xiv) The Turks and Caicos Islands;
- (xv) The US Virgin Islands; and
- (xvi) Vanuatu.

On February 20, 2024, the Council decided to remove the Bahamas, Belize, the Seychelles and Turks and Caicos Islands from the EU list of non-cooperative jurisdictions for tax purposes. Thus, 12 jurisdictions remained on the blacklist, i.e.:

²²⁰⁹ See also Report by the Code of Conduct Group (Business taxation) suggesting amendments to the Annexes of the Council conclusions of December 5, 2017, including the de-listing of one jurisdiction, October 31, 2018 (FISC 423/ECOFIN 949).

- (i) American Samoa;
- (ii) Antigua and Barbuda;
- (iii) Anguilla;
- (iv) Fiji;
- (v) Guam;
- (vi) Palau;
- (vii) Panama;
- (viii) Russia;
- (ix) Samoa;
- (x) Trinidad and Tobago;
- (xi) US Virgin Islands; and
- (xii) Vanuatu.

Belize and the Seychelles (removed from the blacklist) were included in the grey list, while Albania, Aruba, Botswana, Dominica, Hong Kong and Israel were removed from that list. Thus, the following 10 jurisdictions were listed in the grey list, i.e.:

- (i) Armenia;
- (ii) Belize;
- (iii) British Virgin Islands;
- (iv) Costa Rica;
- (v) Curaçao;
- (vi) Eswatini;
- (vii) Malaysia;
- (viii) The Seychelles;
- (ix) Turks; and
- (x) Vietnam.

On October 8, 2024, the Council moved Antigua and Barbuda from ANNEX I to ANNEX II and removed Armenia and Malaysia from ANNEX II. As a result, there are currently 11 jurisdictions on the blacklist, i.e.:

- (i) American Samoa;
- (ii) Anguilla;
- (iii) Fiji;
- (iv) Guam;
- (v) Palau;
- (vi) Panama;
- (vii) Russia;
- (viii) Samoa;
- (ix) Trinidad and Tobago;
- (x) The US Virgin Islands; and
- (xi) Vanuatu.

The nine jurisdictions included in the grey list are:

- (i) Antigua and Barbuda;
- (ii) Belize;
- (iii) British Virgin Islands;
- (iv) Costa Rica;
- (v) Curaçao;
- (vi) Eswatini;
- (vii) The Seychelles;
- (viii) Turks; and
- (ix) Vietnam.

In its semi-annual meeting of February 18, 2025, the Council decided not to bring any changes to ANNEX I. As regards ANNEX II, Costa Rica and Curaçao were considered to have fulfilled their commitments by addressing the deficiencies in their automatic exchange of tax information system, and were thus removed from the list. On the other hand, Brunei Darussalam committed to amending or abolishing its foreign-source income exemption regime before the end of 2026, and this commitment was included in the state of play. The list of jurisdictions in ANNEX II therefore currently comprises: Antigua and Barbuda, Belize, British Virgin Islands, Brunei Darussalam, Eswatini, Seychelles, Turks and Vietnam.

On October 10, 2025, the Council confirmed that there had not been any changes to the EU list of non-cooperative jurisdictions.

On February 17, 2026, the Council added Vietnam and Turks and Caicos Islands to ANNEX I, while Fiji, Samoa and Trinidad and Tobago were removed from that ANNEX. Antigua and Barbuda and Seychelles were removed from ANNEX II.

Comment (1): At its October 10, 2019 meeting, the Council also endorsed the guidance on foreign-source income exemption regimes.²²¹⁰ The guidelines provide directions for third-country jurisdictions that have already made a commitment to amend their foreign-source income exemptions because these exemptions have harmful features identified by the Code of Conduct Group. The guidelines also serve as a basis for the screening of other third country jurisdictions with similar regimes in place prior to the end of 2019. At issue are foreign source income exemption regimes or regimes that charge corporate tax on a territorial basis. They are not, in themselves, problematic, but give rise to problems when such regimes not only prevent double taxation, but also create situations of double non-taxation.

This is particularly the case for regimes that have:

- (i) An overly broad definition of the income excluded from taxation, in particular, foreign source passive income, without any conditions or safeguards; and/or
- (ii) A nexus definition non-compliant with the definition of a permanent establishment contained in the OECD Model Tax Convention.

²²¹⁰The EU list of non-cooperative jurisdictions for tax purposes — Guidance on foreign source income exemption regimes, FISC 386 ECOFIN 877, see <https://data.consilium.europa.eu/doc/document/ST-13075-2019-INIT/en/pdf>.

The published guidelines aim to help third countries comply with the EU tax standards.

Comment (2): The transposition of the OECD BEPS Pillar Two by the Pillar Two Directive may be reasonably expected to

add Pillar Two as a criterion for determining whether a foreign jurisdiction should be included in the EU's list of non-cooperative jurisdictions, potentially resulting in a significant increase in the number of jurisdictions on the list.

XXIII. Anti-Abuse Doctrine

A. Abuse of European Union Law

Executive Summary

This Section analyses the concept of “abuse of EU law” as constructed by the CJEU (XXIII.A., below), the extent to which the prevention of abuse may serve as justification for restrictions on the TFEU fundamental freedoms (XXIII.B., below), and the impact of the abuse of EU law concept on national anti-abuse measures (XXIII.C., below).

The Section ends with a discussion of the question of whether the concept of “abuse of EU law” coincides with the various anti-abuse provisions set out in secondary legislation (for example, the Merger Tax Directive, the Parent-Subsidiary Directive, the Interest and Royalty Directive and the ADAT GAAR) (XXIII.D., below).

The Court of Justice of the European Union (CJEU) developed the concept of “abuse of (primary and secondary) EU law” in a series of nontax cases. Enunciated in a broad and rather circular way,²²¹¹ the underlying idea is that EU law cannot be relied on for abusive or fraudulent purposes.²²¹² The application of EU legislation cannot be extended to cover abusive practices engaged in by economic operators, i.e., transactions carried out not in the context of normal commercial operations, but solely or essentially for the purposes of wrongfully obtaining advantages provided for by EU law.²²¹³

In *Emsland-Stärke*,²²¹⁴ the CJEU defined abuse of EU law from the perspective of:

- (i) An objective element; and
- (ii) A subjective element.

A finding of an abuse requires, first, a combination of objective circumstances in which, despite formal observance of the conditions laid down by the Community rules, the purpose of those rules has not been achieved (...) — [i]t requires, second, a subjective element consisting in the intention to obtain an advantage from the Community rules by creating artificially the conditions laid down for obtaining it.

It is for the national courts to establish the existence of those two elements, evidence of which must be supplied in ac-

cordance with the rules of national law, provided the effectiveness of EU law is not thereby undermined.²²¹⁵

1. The Objective Element

The objective element requires an appreciation of the objective circumstances in the light of the purpose of the EU law provision(s) in question, presupposing the formal observance of the conditions imposed by those rules (i.e., that the applicable conditions are fulfilled from an objective point of view).

Thus, objective circumstances must indicate that, despite the formal observance of the conditions for obtaining an advantage provided for by EU law, the purpose of the rules has not been achieved.

The “objective circumstances” appreciation process is caustic by its very nature as it is dependent on:

- (i) The object; and
- (ii) The purpose

of the EU law rules at issue.

The incompatibility with (or the frustration of) the object and purpose of the rules concerned is established if, based on the objective circumstances, rights or benefits are granted that, from an objective point of view, are not intended for such situations.

The scope of the EU rules relied on must be defined to establish whether the right claimed is, in effect, conferred by such provisions (insofar as it does not manifestly fall outside their scope).

The objective element therefore requires that the purpose of the rules at issue is “knowable” (i.e., capable of being known). This, in turn, implies that the concept of abuse finds its (first) limitation in the principle of legal certainty (see below). According to the CJEU case law, a certain degree of artificiality to a transaction serves as a connecting factor for the existence of the objective element.²²¹⁶

In summary, the objective element relates to objective circumstances that:

- (i) Are “merely formal;”
- (ii) Do not involve “normal commercial operations;”
- (iii) “Create artificial conditions;” or
- (iv) Constitute “wholly artificial arrangements.”

2. The subjective element

The subjective element of abuse of EU law is the intention to obtain an advantage from the EU rules by artificially creating the conditions laid down for obtaining the advantage. Such an intention must be evident from objective factors. In making this assessment, it is not the verification of what intention is decisive for the parties in undertaking certain transactions or creating certain objective elements that is at issue, but rather, what is the purpose of those transactions objectively. That purpose

²²¹¹ See Opinion of Advocate General Maduro in Case C-255/02, *Halifax*, at para. 64.

²²¹² Case C-367/96, *Kefalas* (company law); Case C-373/97, *Diamantis* (company law); Case C-73/06, *Pfanzter Luxembourg*; see earlier, in particular, regarding the freedom to supply services, Case 33/74, *Van Binsbergen*, Case C-148/91, *Veronica Omroep Organisatie* and Case C-23/93, *TV 10*; regarding the free movement of goods, Case 229/83, *Leclerc*; regarding the freedom of movement for workers, Case 39/86, *Lair*; regarding the common agricultural policy, Case C-8/92, *General Milk Products* (concerning a U-turn or circular arrangement involving the flow of goods to enable a financial benefit to be claimed); and regarding social security, Case C-206/94, *Paletta*.

²²¹³ See, *inter alia*, Case C-110/99, *Emsland-Stärke*; Case C-212/97, *Centros*; Case C-456/04, *Agip Petroli*; see also Case 125/76, *Cremer*; Case C-8/92, *General Milk Products*.

²²¹⁴ Case C-110/99, *Emsland-Stärke*.

²²¹⁵ See, to that effect, Joined Cases 205/82 to 215/82, *Deutsche Milchkon- tor and Others*; Case 222/82, *Johnston*; Case C-212/94, *FMC and Others*; and Joined Cases C-418/97 and C-419/97, *ARCO Chemie Nederland and Others*.

²²¹⁶ See Case 229/83, *Leclerc* (albeit implicitly). As from Case C-8/92, *General Milk Products*, the reference to artificiality is explicit and consistent in the CJEU’s relevant case law.

must be determined objectively, by establishing that there is no other economic explanation for the transaction than the obtaining of the benefit granted by the EU rule(s) at issue. In other words, what matters is the “objectivized” subjective element.

Again, the artificial character of a transaction or an arrangement serves as the connecting factor, giving a central and pivotal role to “artificiality” in the concept of abuse. As such, the subjective element is the intention, established from objective factors, to obtain a benefit provided under EU rule(s) at issue by artificially creating the conditions under which the right or entitlement to the relevant benefit arises. Evidence of this must be placed before the national court in accordance with the rules of the relevant national law.

A question left open by *Emsland-Stärke* is whether the intention behind the act in question has to be exclusively or essentially contrary to the purpose of the rule of EU law in question.

3. Abuse of EU Law as a General Principle of EU Law

Prohibition of abuse of EU law, labeled by the CJEU as a general principle of EU law,²²¹⁷ has been transposed — albeit relatively recently — into both the direct and indirect (especially VAT) tax area.²²¹⁸

*Imperial Chemicals Industries*²²¹⁹ contained an embryonic indication that abuse of EU law (in that particular case, the abuse of the Treaty freedoms and, more specifically, the freedom of establishment) required that there be “wholly artificial arrangements” intended to circumvent the tax legislation of a Member State.

In *Marks & Spencer*,²²²⁰ the CJEU repeated that Member States were free to adopt or maintain in force rules having the specific purpose of precluding from a tax benefit wholly artificial arrangements whose purpose was to circumvent or evade national tax law.

In *Halifax*,²²²¹ the CJEU introduced the *Emsland-Stärke* two-pronged test for “abuse” in the VAT sphere.²²²² According

²²¹⁷ Case C-321/05, *Kofoed*. The question of whether abuse of EU law is a general principle of EU law or rather a principle of interpretation of EU law is/ remains a matter of debate.

²²¹⁸ In the direct tax area, abuse of EU law is frequently referred to as “abuse of rights;” see, however, the criticism of Advocate General Maduro in his Opinion in Case C-255/02, *Halifax*: “It is consideration of the objective purpose of the Community rules and of the activities carried out, and not the subjective intentions of individuals, which, in my view, lies at the heart of the Community law doctrine of abuse. I am of the view, therefore, that the use of the term ‘abuse of rights’ to describe what is, according to the case-law of the Court, in essence a principle of interpretation of Community law may actually be misleading. I prefer therefore to use the term ‘prohibition of abuse of Community law’ and will speak of ‘abuse of rights’ only where simplicity so requires.”

²²¹⁹ Case C-264/96, *Imperial Chemicals Industries*.

²²²⁰ Case C-446/03, *Marks & Spencer*.

²²²¹ Case C-255/02, *Halifax*. See also XVII.C.2.f., above.

²²²² Compare with Advocate General Maduro’s Opinion in Case C-255/02, *Halifax*, para. 83: “The criteria for applying to the field of VAT the principle of interpretation prohibiting the abuse of Community law must be established in the light of the specific characteristics and principles of this harmonized system. The test for assessment of the abuse enunciated in *Emsland-Stärke* provides considerable guidance in that regard but the specificity of VAT as a tax of an objective character means that automatic transposition is not to be recommended. (...) the objective analysis of the prohibition of abuse has to be balanced against the principles of legal certainty and protection of legitimate ex-

to the Court, for it to be found that an abusive practice exists, it was necessary that:

(i) The transactions concerned, notwithstanding formal application of the conditions laid down by the relevant provisions of the Sixth Directive and the national legislation transposing it, resulted in the accrual of a tax advantage the granting of which would be contrary to the purpose of those provisions.

(ii) It was apparent from a number of objective factors that the essential aim of the transactions concerned was to obtain a tax advantage.

The CJEU further held that where an abusive practice was found to exist, the transactions involved had to be redefined to reestablish the situation that would have prevailed in the absence of the transactions constituting that abusive practice. However, the prohibition of abuse was not relevant where the economic activity carried out may have had some explanation other than the mere attainment of tax advantages.²²²³

As regards the “exclusive” or “essential” nature of the intention — the question left open in *Emsland-Stärke* (see above) — the ruling in *Halifax* seems to define “essentially” as the relevant boundary. However, it is questionable whether that definition is similarly applicable in the context of EU primary legislation.²²²⁴

In *Cussens & Others v. Brosnan*,²²²⁵ the CJEU confirmed that the VAT abuse of rights principle, enunciated in *Halifax*, also applied to transactions that occurred prior to that decision. This is because the VAT abuse of rights principle is not a rule established by a Directive (which requires transposition), but a principle based on settled case law that merely defines the meaning and scope of EU law as it should have been interpreted from the outset.

In the same ruling, the CJEU also specified the transactions that the national court should consider when applying the “essential aim” aspect of the *Halifax* test: “only the objective of the transaction or transactions whose abusiveness is to be assessed and not that of the supplies which, as a result of those initial transactions, formally satisfy the conditions for obtaining a tax advantage.”²²²⁶

In a second move, the two-pronged test for “abuse,” with its objective and subjective elements, was expanded into the direct tax area by the ruling in *Cadbury Schweppes*,²²²⁷ albeit

expectations that also form part of the Community legal system and in the light of which the provisions of the [VAT] Directive must be interpreted.”

²²²³ The CJEU has provided further guidance on the *Halifax* doctrine in the VAT area in a number of subsequent cases, including Case C-425/06, *Part Service*; Case C-103/09, *Weald Leasing*; Case C-277/09, *RBS Deutschland Holding*; and Case C-419/14, *WebMindLicenses*.

²²²⁴ See, however, Case C-321/05, *Kofoed*, where the test was “solely for the purpose of wrongfully obtaining advantages provided for by Community law” (emphasis added), thus suggesting “exclusive intent.” Certain authors argue that the test should be “exclusive” in the area of the fundamental freedoms, while it should be “essential” (or “predominant”) in the area of EU secondary legislation. This view finds support in Case C-255/02, *Halifax* and in Case C-425/06, *Part Service*, and would imply that the use of “solely” — a synonym for “exclusively” — in *Kofoed* (which concerned the Merger Tax Directive, i.e., EU secondary legislation — see III.D., above) was “negligent.”

²²²⁵ Case C-251/16, *Cussens & Others v. Brosnan*.

²²²⁶ Case C-251/16, *Cussens & Others v. Brosnan*. See in the same vein: Case C-103/09, *Weald Leasing* and Case C-419/14, *WebMindLicenses*.

²²²⁷ Case 196/04, *Cadbury Schweppes*.

by tying it in with the “wholly artificial arrangements” concept that had been formulated in *ICI* and *Marks & Spencer*.

According to the CJEU in *Cadbury Schweppes*, for it to be found that there was a “wholly artificial arrangement,” there had to be:

- (i) A subjective element consisting in the intention to obtain a tax advantage; and
- (ii) Objective circumstances demonstrating that, despite formal observance of the conditions laid down by EU law, the objective pursued by (in that particular case the freedom of establishment had not been achieved).

However, according to the Court, for a wholly artificial arrangement to exist, it was not enough that the taxpayer could have had the intention of saving tax. Nor did such an arrangement exist when a transaction reflected “economic reality” that in turn corresponded to a “genuine economic activity in the host Member State” (the existence of “genuine economic activity” being assessed in terms of “premises, staff and equipment.”) This case law was further elaborated on in subsequent cases such as *Eurowings*,²²²⁸ *Test Claimants in the Thin Cap Group Litigation*,²²²⁹ *Lammers*²²³⁰ and *SGL*.²²³¹

From the relevant CJEU case law, it can be concluded that a wholly artificial arrangement can be found to exist when, by analyzing subjective and ascertainable evidence, the conclusion can be reached that a transaction:

- (i) Lacks any economic reality; and
- (ii) Was not carried out for a valid commercial reason,

but, rather, that the essential objective of the transaction was to obtain a tax advantage.

Consequently, the wholly artificial arrangement doctrine examines a transaction in accordance with a two-pronged conjunctive perspective involving:

- (i) An objective analysis of whether there is ascertainable evidence that the arrangement is not purely artificial (i.e., whether the form of the transaction differs from its substance and whether there is an economic reality underlying the transaction); and
- (ii) A subjective analysis of the taxpayer’s purpose by determining whether the arrangement was made with a legitimate or valid business purpose other than to obtain a purely fiscal advantage.

In *Newey (Ocean Finance)*,²²³² a VAT case, the CJEU held that contractual terms might be disregarded, in particular, if it became apparent that they did not reflect economic and commercial reality, but constituted a wholly artificial arrangement that did not reflect economic reality and had been set-up with the sole aim of obtaining the tax advantage.

²²²⁸ Case C-294/97, *Eurowings*.

²²²⁹ Case C-524/04, *Test Claimants in the Thin Cap Group Litigation*.

²²³⁰ Case C-105/07, *Lammers*.

²²³¹ Case C-311/08, *SGL* (“wholly artificial arrangements” are purely artificial arrangements, devoid of economic reality and created with the aim of escaping the tax normally due on the profits generated by activities carried out in national territory).

²²³² Case C-653/11, *Newey (Ocean Finance)*.

In other words, the consideration of economic and commercial realities is a fundamental criterion for the application of the common system of VAT that, for the purposes of identifying the recipient of a supply of services, may be more decisive than the contractual terms. Arguably, this equation of abuse of law with artificiality and, more specifically, the introduction of the concept of a “wholly artificial arrangement” in the VAT sphere might possibly be seen as an attempt on the part of the Court to apply the concept of abuse of law as used in the context of direct taxation to VAT cases as well.

Evidently, the abuse of EU law concept, as formulated along the lines set out above, is not without its limits.

- (i) The first limit is represented by the principle of legal certainty, i.e., the objective element of abuse requires the purpose and scope of the EU law provision at issue to be “knowable.”²²³³

- (ii) The second limit derives from the recognition, in principle, in CJEU case law of the right to choose the least-taxed route.

Broadly, a taxpayer has, within the boundaries of legality, the right to structure his or her activities in such a way to limit his/her tax liability, i.e., the right to structure his/her tax affairs in the most tax-efficient way. *Cadbury Schweppes*²²³⁴ made it abundantly clear that this holds true even if the taxpayer relies, to that end, on an EU rule, as long as the benefit obtained on that basis and in normal circumstances is inherent in that rule.

As such:

- (i) Tax jurisdiction shopping; or
- (ii) Making use of tax disparities between Member States (tax arbitration)

are and remain, in those circumstances, perfectly workable and permissible.

By contrast, where a wholly artificial arrangement is used to come within the ambit of an EU rule, without achieving the purpose of that rule, there is abuse of law or impermissible tax avoidance.

B. Prevention of Abuse as Justification for Restriction of Fundamental Freedoms

A national measure restricting a fundamental freedom may be justified where it specifically targets wholly artificial arrangements designed to circumvent the legislation of the Member State concerned. The specific objective of such a restriction must be to prevent conduct involving the creation of wholly artificial arrangements that do not reflect economic reality, with a view to escaping the tax normally due on the profits generated by activities carried out in the national territory. See II.C.3.f., above.

In the last decade, especially since *Marks & Spencer*,²²³⁵ there has been an increasing trend in CJEU case law towards

²²³³ See, in this regard, for example, *Halifax*, in which the CJEU emphasized that EU legislation must be certain and its application foreseeable by those subject to it. This requirement must be observed all the more strictly when the rules entail financial consequences so that the extent of the obligations imposed must be clear to the persons concerned.

²²³⁴ Case 196/04, *Cadbury Schweppes*.

²²³⁵ Case C-436/03, *Marks & Spencer*.

combining two or more grounds of justification. In most cases, taxpayers rely on:

- (i) The need to preserve a balanced allocation of taxing powers; and
- (ii) The prevention of tax avoidance.

In the light of these grounds of justifications, when taken together, restrictive tax measures:

- (i) Are considered to pursue legitimate objectives compatible with the Treaty;
 - (ii) Constitute overriding reasons in the public interest; and
 - (iii) Are apt to ensure the attainment of those objectives.
- See II.C.2., above.

In the Danish “beneficial ownership” cases,²²³⁶ the CJEU ruled that the absence of a beneficial ownership requirement in the Parent-Subsidiary Directive did not prevent Member States from denying the benefits of that Directive in instances where there was an abuse of rights. According to the Court, the legal basis for this was the general legal principle that EU law could not be relied on for abusive or fraudulent ends.

Example: EU law cannot be relied on where the underlying transaction is:

- (i) Purely artificial economically; and
- (ii) Designed to circumvent the application of the legislation of the Member State concerned.

Comment: In the author’s perception, the interpretation of the Parent-Subsidiary Directive’s scope by reference to the general principle of abuse of EU law essentially appears to be induced with a view to denying the Directive’s benefits to companies that are not beneficial owners. In other words, the abuse of law “detour” seems to be (deliberately) taken to (nonetheless) render the beneficial owner criterion (because (as opposed to the Interest and Royalty Directive) it is lacking in the Parent-Subsidiary Directive) pertinent as a substantive matter within the context of (or even arguably beyond) that Directive.

This approach, in the author’s view, boils down to the conflation of the beneficial owner concept with the EU general anti-abuse principle. Hence, the question arises as to whether such an abuse of law “detour” might be considered to constitute a valid *modus operandi*. Admittedly, the facts at issue in the Danish dividend cases predated the introduction of the anti-abuse rule in the Parent-Subsidiary Directive and it is likely that, had this not been the case, the CJEU would have relied on that rule (as a specific anti-abuse provision).

C. Impact on Member States’ National Anti-Abuse Measures

In *Kefalas*,²²³⁷ a company law case, after repeating that EU law could not be relied on for abusive or fraudulent ends, the

CJEU held that the application by national courts of domestic rules for the purposes of assessing whether the exercise of a right arising from a provision of EU law was abusive could not be regarded as contrary to the EU legal order.

The CJEU specifically stated, however, that although the Court could not substitute its assessment for that of a national court, which was the only forum competent to establish the facts of the case before it.²²³⁸ The CJEU pointed out that the application of such a national rule could not have prejudiced the full effect and uniform application of EU law in the Member States.²²³⁹ In particular, it was not open to national courts, in assessing the exercise of a right arising from a provision of EU law, to alter the scope of that provision or to compromise the objectives pursued by it.²²⁴⁰

The Court held, therefore, that national anti-abuse measures, whether in the form of statutory rules or doctrines developed in case law, if and to the extent such measures concerned situations in which a taxpayer relied on EU law with a view to avoid tax, had to be specifically designed to prevent abuse of EU law or abuse of rights, as defined by the CJEU. Such measures could not use criteria that were themselves incompatible with EU law. Because anti-abuse measures form a deviation from the application of EU law, they should be applied restrictively, with the burden of proof incumbent on the party invoking the abuse.²²⁴¹ The application of such measures must, moreover, be open to judicial review.

Finally, the CJEU required that national anti-abuse measures passed the proportionality test, comprising:

- (i) A “suitability” test (i.e., the measure had to be suitable for ensuring the attainment of the purpose pursued, implying that there had to be a causal relationship between the national measure and the purpose pursued); and
- (ii) A “necessity” test (i.e., the measure could not go beyond what was necessary to achieve its purpose).

A national anti-abuse measure that has no bearing on abuse of EU law will thus be barred, either because it is too general or unsuitable or because it is not necessary to attain the purpose pursued.

In other words, national anti-abuse measures are only likely to pass the test of EU law if at the same time they:

- (i) Can be applied on a case-by-case basis; and
- (ii) Take account of objective circumstances in assessing the objective element of abuse and establishing the intention of abuse based on objective factors.

From the (nontax) case law of the CJEU, it can also be inferred that more general anti-abuse measures that, having regard to their underlying objective, have a sufficiently specific connection with relevant objective circumstances materializing in an indication of abuse, may be permissible. This would apply to both irrebuttable and rebuttable presumptions of abuse.

²²³⁶ Joined Cases 116/16, *T Denmark* and 117/16, *Y Denmark*. These judgments should be seen in close conjunction with the CJEU’s decisions rendered in Joined Cases C-115/16, *N Luxembourg 1*, C-118/16, *X Denmark*, C-119/16, *C Denmark I* and C-299/16, *Z Denmark*, which concerned the application of the Interest and Royalty Directive, all such cases commonly referred to as the “Danish Beneficial Ownership” cases (see also IV.B.2., above).

²²³⁷ Case C-367/96, *Kefalas*.

²²³⁸ See also Case C-326/00, *IKA*.

²²³⁹ See already Case C-441/93 *Pafitis and Others*.

²²⁴⁰ See also Case C-373/97, *Diamantis*; Case C-201/01, *Walcher*.

²²⁴¹ Case 251/78, *Denkavit Futtermittel*.

Comment: It remains unclear whether such presumptions of abuse would also be acceptable in the tax sphere — it seems doubtful in the case of irrebuttable (general or specific) presumptions (having regard to their quasi-automatic nature). However, it appears quite likely in the case of rebuttable presumptions, at least to the extent they are associated with a reasonable burden of proof on the part of the taxpayer.

Against this backdrop, Member States in many cases need to adjust their national anti-abuse measures and, if they cannot modify or adjust those measures to meet the requirement of freedom from restriction under the free movement provisions of the TFEU, may be forced to abolish such measures altogether.

D. Anti-Abuse Provisions in Secondary Legislation

See the discussions of the anti-abuse provisions contained in the following directives:

- (i) The Merger Tax Directive (see III.D., above);
- (ii) The Parent-Subsidiary Directive (see IV.E., above); and

- (iii) The Interest and Royalty Directive (see V.D., above).

These broadly reflect the general EU law principle or principle of interpretation of EU law that abuse of EU law (or abuse of EU rights) is prohibited, thus seemingly suggesting that they must be interpreted in line with the contents and structural elements of that principle.

See, also, the general anti-abuse rule (GAAR) in the Anti-Tax Avoidance Directive at VI.B.4., above.

However, numerous questions remain. For instance:

- (i) If the intended scope and purpose of these various anti-abuse provisions is to be the same or (at least) similar, why their respective wording is (to some degree) at variance? In other words, is there a risk of mutually conflicting positions?

- (ii) How do these anti-abuse provisions, both specific and general, relate to the fundamental freedoms enshrined in the Treaty on the Functioning of the European Union (TFEU)?

These questions will certainly have to be addressed by the CJEU in the coming years.

XXIV. United Nations Framework Convention on International Tax Cooperation

A. Overview

At the United Nations, countries are negotiating a new UN framework convention on international tax cooperation (UNFCITC).²²⁴² It is intended that the resulting draft UNFCITC will be discussed at the UN General Assembly for approval in 2027.

Generally, the UNFCITC covers the design of standards for international cooperation that encompass national and regional interests on the most critical international taxation issues, including the taxation of multinational companies, the allocation of taxing rights and financial transparency measures. It is also to establish a framework body for negotiating future international tax reforms.

The guiding objectives and principles of the UNFCITC are set out in the Terms of Reference (TOR) that were adopted by the General Assembly of the United Nations on December 24, 2024 (paragraph 2 of its Resolution 79/235).

The objectives identified in the TOR are threefold, i.e., to establish: (i) fully inclusive and effective international tax cooperation in terms of substance and process; (ii) a system of governance for international tax cooperation capable of responding to existing and future tax and tax-related challenges on an ongoing basis; and (iii) an inclusive, fair, transparent, efficient, equitable and effective international tax system for sustainable development, with a view to enhancing the legitimacy, certainty, resilience and fairness of the international tax rules, while addressing the challenges to strengthening domestic resource mobilization.

The guiding principles of the UNFCITC are described in terms of efforts to achieve these objectives. These efforts should:

- (i) Be universal in approach and scope and fully take into account the different needs, priorities and capacities of all countries, including developing countries, in particular countries in special situations;
- (ii) Recognize that every Member State has the sovereign right to decide its tax policies and practices, while also respecting the sovereignty of other Member States in such matters;
- (iii) Be aligned, in the pursuit of international tax cooperation, with States' obligations under international human rights law;
- (iv) Have a holistic, sustainable development perspective that covers economic, social and environmental policy aspects in a balanced and integrated manner;
- (v) Be sufficiently flexible, resilient and agile to ensure equitable and effective results as societies, technology and business models, and the international tax cooperation landscape evolve;

(vi) Contribute to achieving sustainable development by ensuring fairness in the allocation of taxing rights under the international tax system;

(vii) Provide for rules that are as simple and easy to administer as the subject matter allows;

(viii) Ensure certainty for taxpayers and governments; and

(ix) Require transparency and accountability of all taxpayers.

Two “early protocols” have been identified in the TOR. The first addresses the taxation of income derived from the provision of cross-border services in an increasingly digitalized and globalized economy and the second (as specified during the organizational session in February 2025) addresses the issue of preventing and resolving tax disputes. Protocols are separate, legally binding instruments designed to implement or elaborate on a specific topic under the UNFCITC.

All UN Member States, including all EU Member States, participate in the UN Intergovernmental Negotiating Committee. The European Union itself is not a negotiating party, but the EU Commission's External Action Service participated in the preparatory negotiations and is expected to continue assuming that role going forward, reportedly in an attempt to define a common EU position.

The negotiations themselves are non-binding as the decision to sign and ratify the UNFCITC, once approved, lies with the national governments and parliaments. Protocols will only be binding if and when they are signed and ratified by Member States, separately from the UNFCITC. This means that Member States may opt out of becoming a party to a given protocol.

The first organizational session on the UNFCITC was held between February 3, 2025 and February 6, 2025 in New York. Subsequent sessions were held between August 4–8 and August 11–15, 2025 in New York, between November 10–21, 2025 in Nairobi, and between February 2–11, 2026 in New York. The fifth organizational session is scheduled for August 3–13, 2026 in New York.

B. United States Withdrawal from United Nations Framework Convention on International Tax Cooperation

A Statement at the Session for the Intergovernmental Negotiating Committee on the UN Framework Convention on International Tax Cooperation dated February 3, 2025 (i.e., the first day of the February 2025 organizational session), Jonathan Shrier, Acting Representative to the UN Economic and Social Council, announced that the United States “do not plan to participate further in this organizational session, process, or negotiating United Nations Framework Convention on International Tax Cooperation text” as “the goals of a future UN Framework Convention on International Tax Cooperation are inconsistent with US priorities and represent unwelcome overreach.”

The US Statement adds that “we reject the very nature of these discussions. The process that has been adopted will lead to a Convention that would unacceptably hamper nations' ability to enact tax policies that serve the interests of their citizens, businesses, and workers. Further, within these discussions, we underscore our profound objection to the process thus far. We have repeatedly voted “no” to express our concerns with the di-

²²⁴² The UNFCITC is distinct from the already-established Committee of Experts on International Cooperation in Tax Matters (commonly referred to as “the UN Tax Committee”). This consists of experts who operate without government mandate, provides non-binding technical guidance on tax matters and is a subsidiary body of the UN Economic and Social Council.

rection and the evolution of the decision-making process away from consensus and have been met only with inflexibility. Finally, we underscore that the United States intends to reject the outcomes of this Framework Convention process and oppose them. We welcome others to join us in opposition.”

C. European Union/European Union Member States’ Position

The February 2025 organizational session agreed that the rules for decision-making by the Intergovernmental Negotiating Committee will be by simple majority, and decisions related to the early protocols will be made by a two-thirds majority. A last-minute attempt by France, Italy and the Czech Republic to introduce decision-making by consensus was defeated by a vote of 98 to 42.

The “decision-making by consensus” issue had been discussed from the outset and was the reason why the European Union, as a group of countries, abstained from voting on the TOR (which was in draft form at the time) on August 16, 2024.²²⁴³

While the EU Member States operate a relatively high standard of tax cooperation, such cooperation often functions at below par in relation to other non-EU countries. As such, a

more committed participation in the UNFCITC may eventually prove beneficial to the European Union/EU Member States.

Comment: As one of the earlier protocols addresses the taxation of income derived from the provision of cross-border services in a digitalized and globalized economy, the UNFC-ITC might be an appropriate platform for the development of some form of permanent digital levy, even though that is not the priority of the protocol. This is a subject that has been on the European Union’s agenda for a long time.²²⁴⁴

D. Future Prospects

Some commentators are skeptical about the feasibility of the 2027 deadline (see XXIV.A., above), especially because of the details in the protocols. They believe that an extension of time will be necessary. Other commentators contend that a series of votes in mid-2027 will probably force through a final text. The UN General Assembly will then adopt the draft and put it out for signature. Assuming that there are sufficient ratifications, it may be 2029 or 2030 before the UNFCITC enters into force. Moreover, if the UNFCITC needs to be implemented through domestic legislation, the timescale for the UNFCITC to have an impact may well shift into the 2030s.²²⁴⁵

²²⁴³ See EU Explanation of Vote: closing of the second substantive session of the Ad-hoc Committee negotiating draft Terms of Reference on a UN Framework Convention on International Tax Cooperation, https://www.eeas.europa.eu/delegations/un-new-york/eu-explanation-vote-closing-second-substantive-session-ad-hoc-committee-negotiating-draft-terms_en.

²²⁴⁴ Parada, L., Balancing DSTs and Geopolitics: The European Dilemma, Tax Notes, August 11, 2025.

²²⁴⁵ Baker, Ph., The future of international tax reform, Tax Journal, September 17, 2025, <https://www.taxjournal.com/articles/the-future-of-international-tax-reform>.

TABLE OF WORKSHEETS

Worksheet 1

Own Resources.

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