GLOBAL TAX SERIES

European
Tax Handbook
2023

European Tax Handbook 2023

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The 2023 European Tax Handbook includes surveys on 49 countries and jurisdictions. The surveys have been updated to reflect the laws applicable in 2023. A chapter on the European Union (together with the most important tax directives) and descriptions of seven of the most important Swiss cantons are included..

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European Tax Handbook 2023

Global Tax Series

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Preface

IBFD is pleased to present the *thirty-fourth* edition of the *European Tax Handbook*.

The 2023 *European Tax Handbook* covers surveys on 49 countries and jurisdictions. All information on the European tax systems has been updated to reflect, as much as possible, the laws applicable in 2023.

As before, the *European Tax Handbook* includes in addition to the country level surveys, a chapter on the European Union (together with the most important tax directives), as well as descriptions of seven of the most important Swiss cantons, i.e. Basel-Stadt, Bern, Geneva, Schwyz, Vaud, Zug and Zurich.

All the chapters of this book are also available in the online collection Country Surveys of the IBFD Tax Research Platform, which contains descriptions of the tax systems of 53 European countries and, in addition, descriptions of the tax systems of all 26 Swiss cantons. The online title is *European Tax Explorer (Plus)*. It also includes the texts of income tax treaties concluded by all European countries. The online collection Country Surveys has quarterly updates; the chapters are revised as new information becomes available.

More comprehensive coverage of the majority of the jurisdictions can be found in the online collection Country Analyses. A combination of Country Surveys, Country Analyses and the texts of income tax treaties concluded by countries worldwide is offered via the online title *Global Tax Explorer Plus* and regional subsets of this title on Africa, Asia-Pacific, Europe, Latin America and the Caribbean, and the Middle East. Countries in North America can easily be ordered via the online title *Tax Explorer – Country Select*, which enables you to choose the exact countries for which you need coverage on the essentials on international tax. It also offers the possibility to extend this with the very detailed Country Analyses on major economies like Canada and the United States.

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April 2023

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European Union

Direct Taxation

Introduction

The European Union comprises the following 27 Member States: Austria, Belgium, Bulgaria, Croatia, Cyprus, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, the Slovak Republic, Slovenia, Spain and Sweden. The United Kingdom was part of the European Union until 31 January 2020 when the withdrawal process from the European Union was concluded (*see* details below).

Member States, Norway, Iceland and Liechtenstein form the European Economic Area (EEA) from 1 January 1994, by the conclusion of the Agreement of 13 December 1993 on the European Economic Area (94/1). The Agreement covers company law directives, customs and social security legislation and all primary and secondary legislation regarding the Treaty on the Functioning of the European Union (TFEU) treaty freedoms (*see* section 1.1.). The European Union has also concluded several agreements with Switzerland on, inter alia, the free movement of persons as well as the automatic exchange of financial account information, which includes an exemption for cross-border payments of dividends, interest and royalties (Amending Protocol to the European Union-Switzerland Agreement (2015)).

A common currency, the euro, has been introduced in Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Portugal, the Slovak Republic, Slovenia and Spain.

The following is an overview of the most significant of both the adopted and proposed EU regulations and directives covering direct tax. Topical tax developments at EU level are also covered, including Brexit (*see* below), State aid (*see* section 1.5.), global minimum taxation (*see* section 3.6.), taxation of the digitalized economy, including the reallocation of taxing rights (Pillar One) (*see* section 5.1.). the financial transaction tax (*see* section 5.2.) and the windfall tax for energy companies (*see* section 5.3.). Relevant case law of the Court of Justice of the European Union on fundamental freedoms is covered in section 4.

Brexit

Following a referendum held on 23 June 2016 (the so-called Brexit), the United Kingdom voted to leave the European Union and triggered the formal process of leaving the European Union by invoking article 50 of the Treaty on European Union (TEU) on 29 March 2017. The United Kingdom formally withdrew from the European Union at midnight CET on 31 January 2020. From that date until 31 December 2020, the United Kingdom entered into a transition period, regulated under the Withdrawal Agreement, in which the United Kingdom was not represented in EU institutions, agencies, bodies and offices, but EU law still applied under certain conditions (*see* details below).

During the transition period, the European Union and the United Kingdom negotiated the terms of their future partnership in the framework of the political declaration of 17 October 2019. On 30 December 2020, the United Kingdom and the European Union signed a Trade and Cooperation Agreement (TCA) (*see* details below).

The Withdrawal Agreement

The Withdrawal Agreement was concluded on 30 January 2020 by the Council of the European Union (the Council), after the United Kingdom completed the ratification process on 23 January 2020.

The Withdrawal Agreement contains a transitional period during which the European Union treats the United Kingdom as if it were a Member State (with certain procedural exceptions). Such transitional period ended on 31 December 2020.

The most important aspects of the Withdrawal Agreement relating to direct taxation are the following:

- EU social security regulations (*see* section 6.) will remain applicable to EU and UK citizens that, at the end of the transition period, were residents or were subject to the legislation of the United Kingdom or European Union, respectively, as well as to their family members and survivors;
- the Recovery Directive (2010/24) will apply until 5 years after the end of the transition period between Member States and the United Kingdom for, inter alia, claims that relate to amounts that became due or transactions that took place before the end of the transition period;
- for State aid granted before the end of the transition period, for a period of 4 years after the end of the transition period, the European Commission (the Commission) will be competent to initiate new administrative procedures on State aid governed by Council Regulation (EU) 2015/1589 concerning the United Kingdom. The Commission will continue to be competent after the end of the 4-year period for procedures initiated before the end of that period;
- the ECJ remains competent for all judicial procedures (including appeals and referrals) concerning the United Kingdom registered before the end of the transition period, and those procedures should continue until a final and binding judgment is given in accordance with EU rules;
- within 4 years from the end of the transition period, the ECJ will still have jurisdiction over infringement

- conventions and agreements: this includes international agreements, agreements between Member States and agreements between EU institutions.

Regulations are legal instruments of general application and are binding and directly applicable in each Member State.

Directives are binding in respect of the result to be achieved, but – unlike regulations – the manner of their implementation and enforcement is a matter left for the national authorities to determine. In accordance with the case law of the ECJ, a directive is directly enforceable within a Member State only if:
- that Member State fails to (properly) execute the directive by a designated deadline; and
- the provisions of the directive are unconditional and sufficiently clear (theory of *acte clair*).

If these conditions are fulfilled, the provisions of a directive may have a direct effect, and may be invoked before a court, including those provisions which grant rights to companies and individuals, against Member States.

Decisions are binding upon those to whom they are addressed, and are directly applicable. Recommendations and opinions are not binding.

1.3. *Supplementary law*

These sources of EU law, which are not specifically mentioned in the treaties, comprise ECJ case law, international law and general principles of law.

The decisions of the ECJ are official, legally binding interpretations of EU law. The interpretation of EU law by the ECJ plays a major role in the absence of harmonization in the field of direct taxation. In this regard, the interpretation of the four fundamental freedoms (i.e. the free movement of goods, the free movement of persons (including the free movement of EU citizens, the free movement of workers and the freedom of establishment), the freedom to provide services and the free movement of capital and payments) and the interpretation of State aid rules, both regulated under the TFEU, have resulted in an extensive body of case law aimed at preventing cases of discrimination against cross-border activities of companies and distortions in the internal market (*see* section 4.).

Fundamental rights, as guaranteed by the Convention for the Protection of Human Rights and Fundamental Freedoms, as well as those that result from the constitutional traditions common to Member States, are recognized as general principles of EU law.

1.4. *Decision-making with regard to tax policy*

Currently, taxation is the only policy area where decision-making requires unanimity among Member States.

There is, however, an "escape clause" from unanimity, the so-called "enhanced cooperation" mechanism, which is very rarely used. This mechanism can be enacted where the Council fails to secure the necessary level of agreement, but a group of nine or more Member States indicate that they still want to undertake action in the relevant area. The Commission can then withdraw its initial proposal and provide a new one that would only apply between Member States who want to be bound by the new rules. Enhanced cooperation will generally only come into play when the discussions have halted, but significant agreement exists between a substantial number of Member States on the type of rules that they would like to see introduced.

Ongoing examples of difficulty in achieving unanimity in tax policies, e.g. the introduction of the common consolidated corporate tax base (CCCTB, *see* section 3.8.) or a digital services tax (*see* section 5.1.) have pushed the Commission to look for alternative decision-making mechanisms.

As such, the Commission has proposed a gradual shift to qualified majority voting (QMV) that would remove the need for unanimity (COM(2019)8 final of 15 January 2019). In this regard, the Commission invited the European Council to adopt by unanimity a decision authorizing the European Council for Financial and Economic affairs (ECOFIN) to act by a qualified majority in a specific area (based on article 48(7) of the TEU).

In particular, the Commission has suggested that QMV could be initially introduced for measures designed to improve cooperation and mutual assistance between Member States in fighting tax fraud and evasion, as well as for administrative initiatives which would benefit EU businesses (e.g. harmonized reporting obligations) and those in which taxation supports other policy goals (e.g. fighting climate change, protecting the environment or improving public health). The Council could subsequently consider extending the QMV (from 2025) to measures designed to modernize already harmonized EU rules (e.g. VAT and excise duty rules), or to major tax projects such as the above-mentioned CCCTB and a new system for the taxation of the digital economy. On 4 May 2022, the European Parliament adopted a resolution proposing the abolition of unanimity in the Council (2022/2705(RSP)).

1.5. *Harmful tax competition and forbidden State aid*

Tax measures introduced by Member States are subject to State aid rules regulated under the TFEU. Any aid granted by a Member State or through State resources that distorts competition and trade within the European Union by favouring certain companies or the production of certain goods is incompatible with the internal market. Furthermore, Member States must notify the Commission of all new aid measures, and wait for the Commission's decision before they put the measure into effect (*see State Aid procedures* below). Aid granted without the Commission's prior authorization constitutes unlawful State aid. However, in some circumstances, government interventions are necessary for a well-functioning economy. Accordingly, the TFEU, in article 107(2) and (3), also leaves room for some policy objectives for which State aid can be given that is considered compatible with the internal market.

Examples of such aid include financial compensation for the damages caused by natural disasters or exceptional occurrences or to remedy a serious disturbance in the economy of a Member State. In this regard, the Commis-

sion adopted the State aid Temporary Framework to enable Member States to grant several types of aid, including (selective) tax advantages to mitigate the adverse effects of the COVID-19 pandemic. For instance, Member States could decide to take measures, such as implementing wage subsidies and suspending payments of corporate and value added taxes or social contributions. The Framework was in place until 30 June 2022. However, for specific investment and solvency support measures, the Framework can be applied until 31 December 2023. The European Commission maintains a list of measures approved by Member States under the Temporary Framework and articles 107(2)b, 107(3)b and 107(3)c of the TFEU. Similarly, the Commission adopted a State aid Temporary Crisis Framework to enable Member States to support the economy in the context of Russia's invasion of Ukraine until 31 December 2022 (OJ C 131I/1 24.03.2022), which was extended until 31 December 2023.

Another example of compatible State aid which can be considered compatible with the internal market is the State aid framework for research, development and innovation (RDI Framework), which sets out the rules under which Member States can grant State aid to companies for RDI activities, while ensuring a level playing field (C(2022) 7388 final). Under the RDI Framework, Member States can provide aid for R&D projects, feasibility studies, construction of research facilities and testing and experimentation infrastructures and innovation activities. Member States must notify this type of aid to the Commission.

In addition, the Commission has issued many regulations, notices, frameworks, guidelines and communications in respect of State aid.

State aid rules only apply to measures that meet all of the following criteria:
- there is a transfer of state resources;
- an economic advantage is conferred on a firm;
- the measure is selective or specific; and
- the measure affects competition and trade.

With effect from July 2023, the European Commission will also be able to investigate subsidies granted by non-EU public authorities to companies operating in the European Union (*see* Foreign Subsidies Regulation (2022/2560)).

Transfer of state resources

In order to qualify as State aid, the advantage must be granted:
- by a Member State;
- through Member State resources (including national, regional and local bodies; and public institutions (such as banks and foundations)) – *see Germany v. Commission*, Case C-248/84, (1987) ECR 4013; or
- by private or public intermediate bodies appointed by a Member State.

Transfer of state resources can take many forms, including fiscal expenditures (e.g. grants and subsidies or state capital investments), a loss of tax revenues (e.g. via accelerated depreciation allowances or reduced tax rates) or otherwise (e.g. loan guarantees; provisions of a legislative, regulatory or administrative nature; or the practices of tax authorities).

Economic advantage conferred on a firm

The (tax) measure should give the recipient an economic advantage that they would not have received in the normal course of business. The advantage may be provided through a reduction in the undertaking's tax burden in several ways, including:
- a reduction in the tax base (e.g. special deductions or accelerated depreciation);
- a partial or total reduction in the amount of tax (e.g. tax exemptions or tax credits); and
- deferment, cancellation or rescheduling of tax debt.

Examples of economic advantages can be:
- an undertaking buys or rents publicly owned land for less than the fair market price;
- an undertaking is granted a loan by a private party (bank) with a state guarantee;
- an undertaking is selling products, services or assets to a Member State for a price exceeding the fair market price;
- an undertaking receives capital injections from a Member State under conditions that are not at arm's length;
- an undertaking receives public services at fees that are not at arm's length; or
- an undertaking receives a tax payment deferral not based on the applicable domestic law.

A measure does not constitute unlawful State aid in cases where a Member State makes funds available to an undertaking under the same terms and conditions that would be provided in the normal course of events by a private investor applying ordinary commercial criteria (the so-called Market Economy Operator Principle) (Case C-278/92 *Spain v. Commission* [1994] ECR I-4103).

Selectivity or specificity

The aid measure must be specific or selective in that it favours certain undertakings, thereby affecting the balance between certain undertakings and their competitors, or the production of certain goods.

Tax measures that are open to all undertakings in a Member State are in principle "general measures", and do therefore not constitute State aid. To qualify as such, general measures must be effectively open to all undertakings on an equal-access basis, and they may not in effect be reduced in scope through, for example, a discretionary power (that goes beyond the simple management of tax revenue) of the Member State to grant them or via other factors that restrict their practical applicability – *see France v. Commission (Kimberly Clark Sopalin)* (C-241/94).

The criterion of "selectivity" is also met if the relevant measure only applies to part of the Member State's territory, as is the case for regional, local and sectorial measures. In the same way, measures that only favour:
- national products which are exported – *see* Joint Cases 6/69 and 11/69 *Commission v. France* [1969] ECR 561;
- sectors that are subject to international competition;
- an entire sector of the economy;
- undertakings with special (legal) status (e.g. public versus private undertakings); or
- undertakings with a specific function (e.g. holding and/or finance functions),

may constitute State aid.

Nevertheless, Member States may still choose the economic and tax policy they consider most appropriate and spread the tax burden across different industry sectors in a way they feel is most beneficial (intersectoral measures). If they apply without distinction to all undertakings and to the production of all goods and services, the following measures are examples of measures that do not constitute State aid:

– tax measures of a pure technical nature (e.g. tax rates, depreciation rules, deferment schedules, tax exemptions and tax credits, and use of losses regulations); and
– measures pursuing general economic policy objectives through a reduction of the tax burden related to certain production costs (e.g. in respect of R&D, employment, and investments in environment).

Effect on competition and trade

State aid must have a potential effect on the competition and trade between Member States. It is sufficient in this respect if it can be shown that the recipient undertaking carries on an economic activity and that this undertaking operates in a market in which there is trade between Member States.

In the view of the Commission, small amounts of aid (*de minimis* aid) do not affect competition and trade – *see* Commission Regulation (EU) 1407/2013 of 18 December 2013. The ceiling for aid covered by the *de minimis* rule is, in general, EUR 200,000 in a 3-year period.

State aid procedures

After receiving a notification or information concerning alleged unlawful aid, the Commission may start a preliminary investigation to determine if:

– the measure is not aid under EU law (and so it may be implemented);
– the measure constitutes aid that is compatible with EU law; or
– there are serious doubts as to the compatibility of the notified measure with EU State aid rules.

If the Commission has serious doubts (or faces procedural difficulties in obtaining relevant information) about the compatibility of a Member State's aid with EU State aid rules, it must open a formal in-depth investigation under article 108(2) of the TFEU.

The decision to initiate this procedure is then sent to the relevant Member State. This decision contains a summary of the factual and legal bases for the investigation, and includes a preliminary assessment of the measure's compatibility with EU State aid rules. The Member State concerned has the opportunity to respond to this decision.

At the end of the formal investigation, the Commission adopts a final decision. There is, however, no legal time frame within which the in-depth investigation must be completed. The possible outcomes of the investigation are: (i) a positive decision (there is no aid or the aid is compatible); (ii) a conditional decision (the aid is in principle compatible, but implementation must fulfil conditions stated in the decision); or (iii) a negative decision (aid is incompatible and cannot be implemented).

If a negative decision is related to aid that has already been paid out, the Member State must recover that aid (with interest) from the beneficiary (unless such recovery would be contrary to EU law). In this way, the undue advantage granted to a beneficiary is reversed. The Commission then opens a "recovery" case to enforce the implementation of its decision – *see* Commission Notice on the recovery of unlawful and incompatible State aid C/2019/5396, OJ C 247, 23.7.2019.

As regards taxation, incompatible State aid may, however, exist in the following situations (Commission Notice C/2016/2946):

– a preferential treatment of undertakings for collective investments;
– rulings misapplying domestic tax law – available only for certain companies – or providing a more favourable tax treatment compared to other taxpayers which are in a similar factual and legal situation (tax rulings);
– tax settlements that disproportionately reduce the tax due without a clear justification;
– depreciation incentives for certain types of assets or undertakings, if they are not based on the guiding principles for the depreciation rules; and
– reduced excise duties.

Some of the more recent and notable procedures and decisions (many of which concern tax rulings) regarding State aid include *UK CFC Group Financing Exemption* (Case SA.44896 – T-363/19 and T-456/19; currently before the ECJ (C-556/22 P)), *Gibraltar corporate income tax regime* (Case SA.34914 (2013/C) – T-241/19; T-508/19), *Nike* (Case SA.51284 – T-648/19), *Mc Donald's* (Case SA.38945), *Amazon* (Case SA.38944 – currently before the ECJ (C-457/21 P)), *Starbucks* (Case SA.38374 – T-760/15), *Apple* (Case SA.38373 – currently before the ECJ (C-465/20 P)) and *FIAT* (Case SA.38375 – C-885/19 P). For details on the decisions covering transfer pricing issues, *see* section 7.

2. Harmonization of Company Law

Several types of legal entities can be formed under European law. Specifically, these are:

– the European company (*Societas Europaea*, SE) (*see* section 2.1.);
– the European economic interest grouping (EEIG) (*see* section 2.2.); and
– the European cooperative society (*Societas cooperativa Europaea*, SCE) (*see* section 2.3.).

2.1. *European company*

Under Council Regulation 2157/2001/EC of 8 October 2001 (SE Regulation), effective from 8 October 2004, it is possible to form a European company (SE). The SE is intended to facilitate cooperation within the European Union and the cross-border reorganization of companies within the EEA across the frontiers of Member States. The SE Statute applies not only to Member States, but also to EEA states. The name of an SE must be preceded or followed by the abbreviation SE.

Under the SE Regulation, an SE can be established by a merger, by the formation of a holding company or by the

creation of a joint subsidiary. The minimum share capital is EUR 120,000. The SE Regulation does not contain provisions concerning groups of companies.

An SE is resident in the Member State of its real seat, which is not necessarily the Member State of its statutory seat.

For tax purposes, SEs are treated the same as public limited liability companies that are formed under the national laws of a Member State. Losses of an SE's foreign permanent establishment can be offset against the SE's profits. If, however, such a permanent establishment becomes profitable later, those profits may be taxed in the Member State of the SE up to the amount of losses previously deducted. The SE Regulation does not contain any provisions on the tax treatment of losses suffered by subsidiaries.

2.2. *European economic interest grouping*

Under Council Regulation (EEC) 2137/85 of 25 July 1985, fully effective from 1 July 1989, it is possible to form a European economic interest grouping (EEIG).

The purpose of an EEIG is to facilitate or develop the cross-border economic activities within the European Union of its members, and to improve or increase the results of these activities.

An EEIG may not be formed for the purpose of making profits for itself. In the event that an EEIG earns profits as an ancillary result of its activities, the taxation system applicable to such profits is comparable to that commonly applied to partnerships; the EEIG itself is not to be taxed, but its profits may be taxed in the hands of its members.

2.3. *European cooperative society*

Under Council Regulation (EC) 1435/2003 of 22 July 2003, effective from 18 August 2006, it is possible to form a European cooperative society (SCE). Like SEs (*see* section 2.1.), SCEs may be established in EU Member States, Iceland, Liechtenstein and Norway (i.e. in the EEA).

An SCE has legal personality (with subscribed capital divided into shares), and must have members from (at least) two different Member States. The amount of capital or number of members is variable.

Each Member State must treat an SCE as a cooperative formed in accordance with the laws of the Member State where its registered office is located.

For tax purposes, an SCE is treated the same as a cooperative society that is formed under the national laws of a Member State.

3. Harmonization of Corporate Taxation

There are four Directives that seek to harmonize certain tax provisions in the field of direct taxation among different Member States. These are:

- the Parent-Subsidiary Directive (2011/96) – which aims to, inter alia, eliminate tax obstacles to cross-border distributions of intra-group profits (*see* section 3.1.);
- the Interest and Royalties Directive (2003/49) – which aims to eliminate withholding taxes on cross-border interest and royalty payments between related companies (*see* section 3.2.);
- the Merger Directive (2009/133) – which aims to eliminate tax hurdles to cross-border corporate reorganizations (*see* section 3.3.); and
- the Anti-Tax Avoidance Directive (2016/1164) (ATAD) and the Amending Directive to the 2016 Anti-Tax Avoidance Directive (2017/952) (ATAD 2) – which contain anti-abuse measures against common forms of aggressive tax planning (*see* section 3.4.).

In addition, there are several proposed directives, such as:

- a directive to tackle the misuse of shell companies (*see* section 3.5.);
- a directive to introduce global minimum taxation of large multinational enterprises (*see* section 3.6.);
- a directive introducing an allowance on equity (*see* section 3.7.);
- a directive to introduce a CCCTB, including the possibility for EU group companies to consolidate for tax purposes (*see* section 3.8.); and
- directives to tax the digitalized economy (*see* section 5.1.).

3.1. *Parent-Subsidiary Directive*

A Directive aimed at reducing the differences between taxation rules for nationally organized groups of companies and taxation rules for EU-wide groups was adopted by the Council on 23 July 1990 (90/435) – the Parent-Subsidiary Directive (90/435). This Directive had two purposes:

- to ensure that the Member State of the parent company either refrains from taxing the profits distributed by a subsidiary that is resident in another Member State or, if taxing such profits, authorizes the parent company to deduct from the amount of tax due the corporate income tax paid by the subsidiary in the other Member State; and
- to exempt from withholding tax profit distributions by the subsidiary to the parent company.

The implementation deadline of the Directive for Member States was 1 January 1992.

The Parent-Subsidiary Directive (90/435) was amended by Amending Directive to the Parent Subsidiary Directive (2003/123), which extended its application to cases in which profit distributions by subsidiaries in one Member State are received by permanent establishments of companies situated in another Member State.

In the interest of clarity, a recast version of the Directive and its successive amendments was adopted on 30 November 2011, Parent-Subsidiary Directive (2011/96) (the Directive). The recast version repealed the previous versions of the Directive, and entered into force on 20 December 2011. The implementation deadline for Member States was 1 January 2012.

Scope

The Directive applies to the following distributions:

- distributions of profits received by a parent company in one Member State from a subsidiary in another Member State;
- distributions of profits by a subsidiary in one Member State to its parent company in another Member State;
- distributions of profits, received by a permanent establishment situated in one Member State, of a company established in another Member State, which are made by a subsidiary established in a Member State other than the Member State where the permanent establishment is situated; and
- distributions of profits by a company of a Member State to a permanent establishment situated in another Member State of a company of the same Member State as the company making the distribution.

Definition of "company of a Member State"

The Directive defines "company of a Member State" as any company that:

- takes one of the *forms* listed in Part A of Annex I to the Directive;
- is considered to be a *resident* of a Member State for tax purposes according to the national laws of that Member State, and is not considered to be a resident for tax purposes outside the European Union under the terms of a tax treaty with a non-EU Member State; and
- is *subject* to one of the taxes listed in Part B of Annex I to the Directive, or to any other tax that may be substituted for any of the expressly mentioned taxes, without the possibility of an option or of being exempt.

All of the three above-mentioned criteria must be cumulatively met.

Dual resident companies can still qualify for the Directive where, generally, taxing rights remain in a Member State, specifically:

- a company incorporated under the laws of a Member State but having its effective place of management and control in another Member State;
- a company incorporated (and fully taxable) under the laws of a Member State but having its effective place of management and control in a state outside the European Union (and therefore being fully taxable in that state) while no tax treaty has been concluded between these two states;
- a company incorporated (and fully taxable) under the laws of a state outside the European Union but having its effective place of management and control in a Member State (and therefore being fully taxable in that Member State) while no tax treaty is concluded between these two states; and
- a company incorporated (and fully taxable) under the laws of a Member State but having its effective place of management outside the European Union, where between these two states a tax treaty is concluded that allocates the taxing rights to the Member State.

Private and public companies limited by shares, as well as SEs (*see* section 2.1.) and cooperatives (*see* section 2.3.) are under the scope of the application of the Directive. Otherwise, it is left to each Member State to decide which entity forms are covered. Some Member States expressly included in Part A of Annex I to the Directive an exhaustive list of all national entity forms covered. Other Member States have not included an express list of all possible national entity forms in the Annex, but they have determined broadly that all national company forms incorporated under the law of the State concerned fall under the scope of the Directive, provided that the other two criteria set forth are met.

Qualifying shareholding

A qualifying parent-subsidiary relationship exists if the parent company holds at least 10% of the issued shares of the subsidiary. Member States are allowed to replace, by means of bilateral agreement, this criterion by that of a holding of voting rights. Additionally, Member States are also permitted to require a minimum holding period not exceeding 2 years, but they are not allowed to require that the minimum holding period has already come to an end at the time when the profit distribution is made – *see Denkavit I* (Case C-283/94). Member States are free to define procedures under their own national law to assure that the 2-year holding period is met.

Tax treatment

When a parent company (or permanent establishment thereof) receives distributed profits from a qualifying subsidiary established in another Member State, the Member State of that parent (or permanent establishment) must either:

- not tax such distributions (i.e. exempt them); or
- relieve any economic double taxation by way of a(n) (indirect) credit for the fraction of the corporation tax paid by the qualifying subsidiary – or any qualifying lower-tier subsidiary – in relation to the profits distributed.

Member States may consider part of the distributed income as "management costs relating to the holding", and not exempt that part from taxation. Where these costs are fixed as a flat rate, the fixed amount may not exceed 5% of the profits distributed by the subsidiary. France, Germany, Italy, Slovenia and Spain have fixed these (management) costs at 5% of the dividends received. As a consequence, these countries in fact only exempt 95% of the dividends received.

The Member State of the parent company may also refuse the deduction of a subsidiary's losses (from the taxable profits of the parent company) resulting from the distribution of the subsidiary's profits.

These possibilities may be exercised only in accordance with the EU fundamental freedoms and within the limits of the Directive. In particular, Member States may not generally deny the deductibility of costs related to a holding in another Member State until the profits from the shareholding are taxable – *see Bosal* (Case C-168/01). Likewise, Member States may not deny the deductibility of the interest paid by a parent company when such interest does not relate to the financing of the holding – *see Argenta Spaarbank NV* (Case C-39/16). Member States cannot impose the liability to make an advance

payment which exceeds the 5% threshold on a parent entity when redistributing profits received by its subsidiaries to its shareholders (even if such profits have not been subject to corporate income tax at the regular corporate income tax rate) – *see Schneider Electric and Others* (Case C-556/20).

In addition, under the Amending Protocol to the European Union-Switzerland Agreement (2015), dividends paid by subsidiaries to parent companies, whereby one is established in the European Union and the other in Switzerland, are exempt if the parent company maintains a direct minimum holding of 25% for at least 2 years in the subsidiary (paying) company.

Anti-abuse

The Parent-Subsidiary Directive (2011/96) has been amended by two Directives to address double non-taxation concerns and abuse.

Directive 2014/86

On 8 July 2015, the Council adopted Amending Directive to the 2011 Parent-Subsidiary Directive (2014/86) to prevent double non-taxation through the use of hybrid financing arrangements. Member States had to implement this Directive by 31 December 2015 at the latest.

Under the amending Directive, Member States must refrain from taxing qualifying profit distributions to the extent they are not deductible by the subsidiary.

This anti-hybrid rule aims to prevent groups of companies from structuring their intra-group payments, through the use of hybrid instruments, to realize mismatches and double non-taxation outcomes. Such mismatch might occur if the Member State of the borrower qualifies a payment as debt, while the Member State of the parent company qualifies the payment as equity. As a result, the amount paid (qualifying as interest) would be deductible in the first Member State and not taxable in the other (qualifying as dividend). The anti-hybrid rule prevents this effect.

Directive 2015/121

On 27 January 2015, the Council adopted the Amending Directive to the 2011 Parent-Subsidiary Directive (2015/121) that introduced a general anti-abuse provision (GAAR) into the Parent-Subsidiary Directive (2011/96). Member States had to implement this Directive by 31 December 2015 at the latest.

Under the GAAR, Member States shall not grant the benefits of the Parent-Subsidiary Directive (2011/96) to an arrangement (or series of arrangements) which (i) has 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 (the subjective test or the main purpose test); and (ii) is not genuine, having regard to all relevant facts and circumstances (the objective test).

The subjective test is not met if the tax advantage of the structure is not derived from the Directive (e.g. avoidance of withholding tax on dividends) or no tax advantage is gained at all. The wording of the main purpose test is largely consistent with the principal purpose test set out in Action 6 of the BEPS Action Plan, which denies treaty benefits if the structure that is set up has tax avoidance as one of its main purposes.

An arrangement (or series thereof) is "not genuine" to the extent that it is not put into place for valid commercial reasons which reflect economic reality. In order to be treated as genuine, the company invoking the Directive should have sufficient substance (e.g. it conducts a material business enterprise).

Application of the GAAR requires an individual examination of the whole operation at issue. The competent authorities may not, therefore, confine themselves to applying predetermined general criteria. The imposition of a general tax measure that automatically excludes certain categories of taxable persons from the tax advantage without the tax authorities having to provide evidence of fraud and abuse, would go further than what is necessary for preventing fraud and abuse. For example, the mere fact that a company residing in a Member State is directly or indirectly controlled by residents of third states does not, in itself, indicate the existence of abuse – *see Deister and Juhler* (Joined Cases C-504/16 and C-613/16) and *Eqiom and Enka* (Case C-6/16).

Nevertheless, the tax authorities may consider some situations as indications of abuse. For example, abuse may be present if dividends received are passed on wholly or partially shortly after they are received (even where no legal obligation to pass on such dividends exists), the recipient lacks substance, or the recipient is interposed to obtain the benefits of the Parent-Subsidiary Directive (2011/96). Accordingly, domestic safe harbours (e.g. a minimum level of substance in order for a structure not to qualify as abuse) may not hold – *see T-Danmark* (Cases C-116/16 and C-117/16).

Member States must deny treaty benefits if an arrangement constitutes abuse of rights, even if the Member State has not implemented any specific anti-avoidance legislation in its domestic law. This requirement flows from the general EU anti-abuse principle – *see Z-Denmark v. Skatteministeriet* (C-299/16) and *T-Danmark* (C-116/16 and C-117/16).

The GAAR does not preclude the application of domestic or agreement-based provisions required for the prevention of tax evasion, tax fraud or abuse.

3.2. *Interest and Royalties Directive*

Scope

On 3 June 2003, the Council adopted Interest and Royalties Directive (2003/49) to eliminate withholding taxes on interest and royalty payments between related companies of different Member States (the Directive). The implementation deadline for Member States was 1 January 2004.

Definition of "company of a Member State"

The Directive defines "company of a Member State" as any company that:
- takes one of the *forms* listed in the Annex to the Directive;
- is considered to be a *resident* of a Member State for tax purposes according to the national laws of that Member State, and is not considered to be a resident

for tax purposes outside the European Union under the terms of a tax treaty with a non-EU Member State; and
- is *subject* to one of the taxes listed in article 3(a) of the Directive, or to any other tax that may be substituted for any of the expressly mentioned taxes, without the possibility of an option or of being exempt. Based on the wording of the article, only the (recipient) company seems to be required to be subject to tax, without the interest or royalty income being effectively subject to tax in the Member State of residence. However, the ECJ noted in *N Luxembourg 1* (Joined Cases C-115/16, C-118/16, C-119/16 and C-299/16) that to the extent that the interest received by an entity (in this case by Luxembourg resident SICAR) is exempt from profits tax in Luxembourg, this entity does not qualify as a "company of a Member State".

All of the three above-mentioned criteria must be cumulatively met.

Qualifying shareholding

As mentioned above, the Directive applies to interest and royalty payments between related companies. Companies are "related" if:
- one company has a direct holding of at least 25% of the capital of the other company (or vice versa). Member States can opt to replace the minimum shareholding requirement with that of a minimum holding of voting rights; or
- a third company has a direct holding of at least 25% of the capital of each of the two companies. The third company (holding at least 25% of the capital of two qualifying companies) does not seem to be required to be a resident of a Member State.

A Member State may decide not to apply the Directive if the 25% shareholding requirement has not been maintained for at least 2 years.

Moreover, before applying the Directive, the Member State in which the payment arises may request that an attestation be submitted stating that the requirements set out in the Directive are met (e.g. the 25% shareholding, residence of the recipient, beneficial ownership). Inability to provide such attestation may lead to the relevant Member State refusing to apply the Directive. The attestation must be valid for at least 1 year, but no more than 3 years.

If both the payer and the recipient are residents of the same Member State, the Directive does not apply.

Tax treatment

Under the Directive, interest or royalty payments that arise in a Member State are exempt from any taxes imposed on such payments in that State if the beneficial owner of the interest or royalties is a related company of another Member State (or a permanent establishment thereof).

The beneficial owner is not a formally identified recipient, but rather the entity that economically benefits from, and has the freedom to use and enjoy, the interest and/or royalties. In this regard, the OECD Model Tax Convention on Income and on Capital: Commentary on Articles 11 and 12 is relevant for interpreting the term "beneficial owner" – *see N Luxembourg 1* (Joined Cases C-115/16, C-118/16, C-119/16 and C-299/16).

A permanent establishment can be considered the beneficial owner of the interest and/or royalties provided two requirements are met:
- the receivable, the right, or the use of information in respect of which the interest and/or royalties are received can be allocated to this permanent establishment (because they are instrumental in the business carried on by the permanent establishment based on the internationally accepted allocation rules); and
- the interest and/or royalties are subject to a profit tax in the country where the permanent establishment is located. The Directive does not prescribe a minimum level of taxation in the Member State where the permanent establishment is located.

The Directive aims to eliminate double taxation in the source Member State at the level of the recipient of the interest and/or royalties and therefore only eliminates legal double taxation. Member States may, accordingly, limit the deductibility of the payment from the debtor's tax base – *see Scheuten Solar Technology* (Case C-397/09).

In relation to Switzerland, under the Amending Protocol to the European Union-Switzerland Agreement (2015), Member States must exempt interest and royalty payments to companies resident in Switzerland, and vice versa, under essentially the same conditions as those laid down in the Interest and Royalties Directive (2003/49).

Anti-abuse

The Interest and Royalties Directive (2003/49) does not preclude the application of domestic or agreement-based provisions that aim to prevent fraud or abuse. Where the principal motive or one of the principal motives of the transaction is tax evasion, tax avoidance or abuse; Member States can withdraw or refuse application of the Directive. The terms "evasion", "avoidance" and "abuse" are not defined in the Directive.

Application of this rule requires an individual examination of the whole operation at issue. The competent authorities may not, therefore, confine themselves to applying predetermined general criteria – *see Deister and Juhler* (Joined Cases C-504/16 and C-613/16) and *Eqiom and Enka* (Case C-6/16).

Nevertheless, the tax authorities can consider some situations as indications of abuse. For example, abuse may be present if the interest and/or royalties received is passed on wholly or partially shortly after it is received (even where no legal obligation to pass on such interest and/or royalties exists), the recipient lacks substance, or the recipient is interposed solely to obtain the benefits of the Directive. Accordingly, domestic safe harbours (e.g. a minimum level of substance in order for a structure not to qualify as abuse) may not hold.

The general principle of EU law, according to which EU law cannot be relied on for abusive or fraudulent purposes, requires that the taxpayer be refused the benefits under the Directive and fundamental freedoms, even where no domestic or agreement-based provisions exist upon which such a refusal may be based. Proof of abuse requires a combination of objective and subjective elements – *see N Luxembourg 1* (Joined Cases C-115/16, C-118/16, C-119/16 and C-299/16).

3.3. *Merger Directive*

The Merger Directive (2009/133) (the Directive), which constitutes a codified version of the previous Merger Directive (90/434) and its amendments, aims to facilitate cross-border reorganizations within the European Union. The Directive provides for the deferral of the taxation on unrealized capital gains on certain cross-border reorganizations. Such transactions should not cause immediate direct tax consequences (i.e. corporation taxes, income taxes and capital gains taxes) to the participating companies and their shareholders. The related taxation is deferred up to the moment in which such assets are retransferred.

The objective of Merger Directive (90/434) is to facilitate cross-border mergers, divisions and similar transactions between companies established in Member States. The implementation of Merger Directive (90/434) enables groups of companies to reorganize their activities into the most appropriate structure for operating within the European Union without incurring the tax costs which would otherwise generally apply to such transactions.

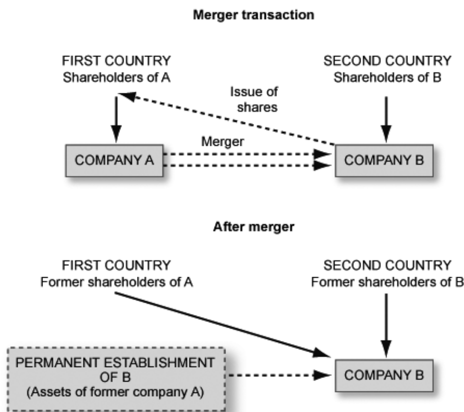
Scope

The Directive covers the following five types of corporate reorganizations:

– *Mergers* in which one or more companies, on being dissolved without going into liquidation, transfer all their assets and liabilities to another existing or new company. In exchange, the shareholders of the transferor companies receive shares in the capital of the transferee company and, if applicable, a related cash payment not exceeding 10% of the nominal value of those shares. This also includes the situation where a wholly owned subsidiary transfers all its assets and liabilities to the parent company.

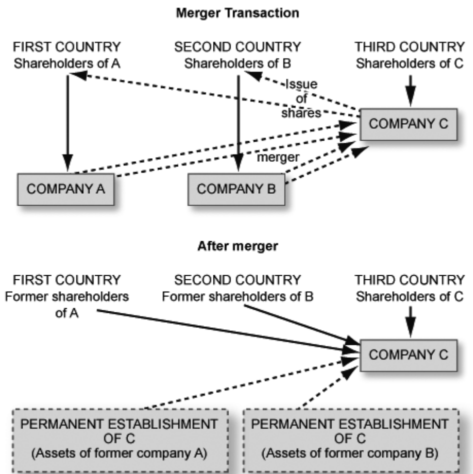
First alternative

One or more companies are merged into another already existing company.



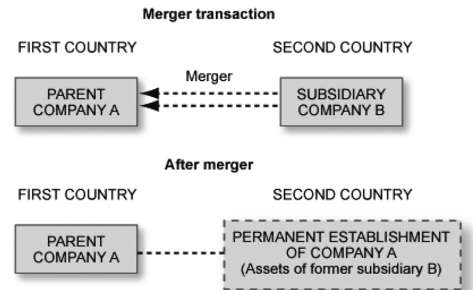
Second alternative

Two or more companies are merged into another new company.

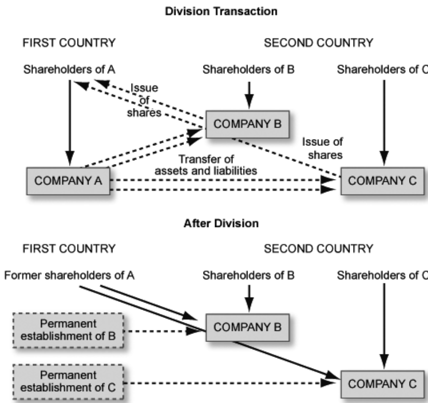


Third alternative

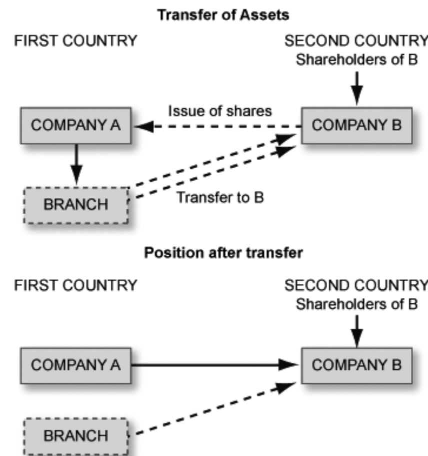
A company transfers all of its assets and liabilities to its parent company which owns 100% of the shares.



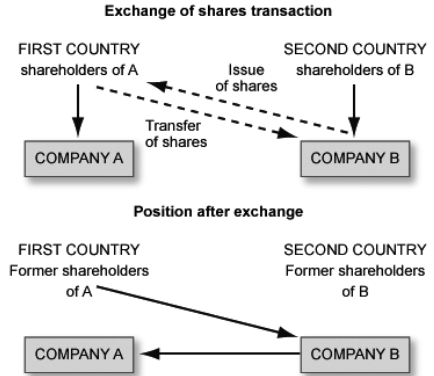
– *Divisions* of companies in which a company, on being dissolved without going into liquidation, transfers assets and liabilities to two or more existing or new companies. In exchange, the shareholders of the transferor company receive shares in the capital of the transferee companies and, if applicable, a related cash payment not exceeding 10% of the nominal value of those shares.



– *Partial divisions* in which a company, without being dissolved, transfers one (or more) branches of activity to one (or more) existing or new companies, and at least one branch of activity remains with the transferring company. In exchange, the transferring company receives securities and possibly a cash payment of up to 10% of the nominal value or, in the absence of a nominal value, of the accounting par value of those securities. This cash payment has practical reasons, as computing an exact amount of shares to be exchanged for other shares can be difficult.
– *Transfers of assets* in which there is a transfer of one or more branches of a company's activities to another company in exchange for shares in the capital of the transferee company.



– *Exchanges of shares* in which a company acquires a holding in the capital of another company such that it obtains the majority of the voting rights in that company. The Directive also covers a transaction whereby a company already holding such a majority, acquires a further holding. The acquiring company issues to the shareholders of the acquired company securities that represent the capital of the acquiring company in exchange for their securities. As with mergers and divisions, a cash payment of up to 10% of the nominal value or, if there is no nominal value, of the accounting par value of the securities issued may be included in the transaction.



The Directive also applies to split-offs and to the conversion of branches to subsidiaries.

Branch of activity

A branch of activity is defined as all the assets and liabilities of a division of a company which from an organizational point of view constitute an independent business, i.e. an entity capable of functioning by its own means.

The independent operation of the transferred business must be determined primarily from a functional and only secondarily from a financial point of view. The assets transferred must be capable of operating as an independent undertaking without requiring additional investment. The fact that a company receiving a transfer takes out a bank loan under normal market conditions cannot in itself mean that the transferred business is not independent, even if the loan is guaranteed by its shareholders. However, if the financial situation of the receiving company as a whole would inevitably point to the conclusion that it would not be able to survive by its own means, the transferred business might not be regarded as independent. Such assessment as to whether or not a business is independent must be left to the national court, having regard to the particular circumstances of each case – *see Andersen og Jensen* (Case C-43/00).

Definition of "company of a Member State"

For the purposes of the Directive, "company of a Member State" means a company meeting the following three requirements:

– The company takes one of the company forms listed in the Annex to the Directive for the country in which it is established.

- The company must be resident in a Member State under the tax laws of that Member State. However, a company does not qualify if, on the basis of a tax treaty with a third (i.e. non-EU) state, the company results in being resident of that third state. Dual resident companies are excluded from the scope of the Directive to prevent such treaties from being used to avoid ultimate tax liabilities within Member States. For example, without this provision, assets might be transferred under a merger transaction to a receiving company such that the taxation otherwise arising on capital gains relating to the assets transferred is deferred in accordance with the reliefs under the Directive. When, however, the receiving company finally disposes of the assets transferred to it (at which stage the gains on which taxation has been deferred would normally be brought into charge to tax), a tax treaty may prevent the Member State of the receiving company from taxing the gains on the grounds that (i) the receiving company is resident in a country outside of the European Union under the terms of a tax treaty; and (ii) the treaty reserves the right to tax such gains to that non-EU Member State.
- The company must be subject to one of the taxes listed in the Annex to the Directive, without the option of being exempt.

The Directive also applies to SEs (*see* section 2.1.), cooperatives, mutual companies, certain non-capital-based companies, savings banks, funds and associations engaged in a business.

Tax treatment

The Directive provides that capital gains (i.e. the differences between the "real values" of the assets and liabilities transferred and their values for tax purposes) arising in relation to the transfer of assets and liabilities in a merger, division or transfer of assets are not subject to tax. The term "value for tax purposes" is defined as the value on the basis of which any gain or loss would have been computed for tax purposes in the transferring company if the assets or liabilities had been independently sold at the time of the transaction. Taxation is deferred up to the moment when a subsequent transfer of the assets takes place.

The scope of the reliefs available under the Directive is, however, limited to assets and liabilities of the transferring company which become effectively connected with a permanent establishment of the receiving company in the Member State of the transferring company and play a part in generating the profits or losses taken into account for tax purposes of that receiving company. As such, the existing book values of the transferred assets and liabilities are maintained by the permanent establishment of the receiving company in the Member State of the transferring company. A future realization of a capital gain upon the alienation of assets and/or liabilities for which in the past tax deferral was granted, will constitute taxable income of the permanent establishment in the Member State that granted the tax deferral. The purpose of these restrictions is to ensure that the Member State of the transferring company retains the assets and liabilities within its taxing jurisdiction even though no tax has been charged on the transfer to the receiving company. In this way, the financial interests of the Member State of the transferring company are safeguarded.

A further prerequisite for the tax deferral is that the receiving company continues the depreciation method and computation method for any gains and/or losses with respect to the assets and liabilities transferred, as used by the transferring company. Consequently, if under the tax laws of a Member State the receiving company may opt for a step-up in basis, relief does not apply to the assets and liabilities for which such option is exercised.

The Directive also addresses the situation where the transferring company in a merger, division or transfer of assets has provisions or reserves on its balance sheet that are partly or wholly exempt from tax. Without a specific relief, a merger, division or transfer of assets would often create a tax charge in respect of tax-exempt reserves and provisions present in the transferring company. The Directive therefore imposes a requirement on Member States to provide relief from such taxation. The relief takes the form of a deferral of taxation rather than a permanent relief in that the provisions or reserves may only be carried over with the same tax exemption by a permanent establishment of the receiving company situated in the Member State of the transferring company. The receiving company is furthermore required to assume the rights and obligations of the transferring company. Accordingly, the Member State of the transferring company will have a future opportunity to tax the receiving company in respect of the reserves or provisions if and when they are released.

If the domestic tax laws of a Member State provide – in pure domestic mergers, divisions and asset transfers – for the possibility of carrying over the tax losses not yet exhausted from the transferring company to the receiving company, such carry-over of losses should also be extended to the equivalent transactions under the Directive. Consequently, in that instance, the Member State of the transferor company would have to permit the permanent establishment of the transferee company to carry forward prior losses of that same business.

However, Member States may restrict the transfer of losses if the disappearing company is a resident of another Member State while allowing the transfer of losses between domestic companies, to the extent that the losses are not "final". In this sense, Member States must give the domestic receiving company the possibility to show that the disappeared, transferring company of the other Member State has exhausted all possibilities to use these losses itself, and that no other company can use these losses in the future – *see Veronsaajien oikeudenvalvontayksikkö and Valtiovarainministeriö v. Oy A* (C-123/11). As such, the receiving company should be allowed to deduct the losses of the transferring company only if it can demonstrate that it is impossible to use the losses in the disappearing company's jurisdiction in future years. In this respect, it is not sufficient – nor decisive – that such losses cannot be transferred upon a merger, as there can be other ways that these losses may be offset against future profits in the transferring jurisdic-

tion (e.g. through a sale of the transferring entity to a third party) – *see Memira Holding AB v. Skatteverket* (C-607/17).

The Directive provides for relief from the taxation that would otherwise arise to the shareholders of the transferor company on the exchange of shares arising in connection with a merger, division or an exchange of shares. However, the relief is provided by means of a "rollover" so that the taxation of such gains is deferred until the shares acquired are disposed of.

A cash payment, however, may be taxed in the hands of the shareholders even if the payment does not exceed the 10% maximum, provided the shareholder attributes to the securities received a higher value for tax purposes than the value the securities exchanged had immediately before the merger, division or exchange of shares.

Gains earned by the transferee company upon the cancellation of a substantial participation, held by the transferee company in the capital of the transferor company prior to the reorganization, are not taxed under the provisions of the Directive.

If the Commission's proposal for a CCCTB (*see* section 3.5.) were to be adopted, the CCCTB regime would replace the Directive with regard to mergers within a group that has opted for a common consolidated tax base regime. The proposed provisions stipulate that an intragroup reorganization and a seat relocation of a group company shall not give rise to profits or losses for the purpose of determining the consolidated tax base. However, for a merger between two groups of companies, the Directive would remain applicable.

Anti-abuse

The Directive allows Member States to deny the benefits of the Directive where the reorganization has as its principal objective, or as one of its principal objectives, tax evasion or tax avoidance. The fact that a transaction is not carried out for valid commercial reasons may constitute a presumption that the transaction has tax evasion or avoidance as one of its principal objectives.

Due to the general nature of this anti-abuse clause, many Member States have introduced additional anti-abuse provisions in their domestic laws. As Member States hold different views on what is abusive, this has led to referrals to the ECJ, which was asked to decide whether such additional domestic conditions are in line with the Directive.

General rules that automatically exclude certain categories of operations from the benefits of the Directive on the basis of general criteria – e.g. the acquiring company does not carry on business by itself; the same person wholly owns all companies involved; or there is no joining of businesses – irrespective of whether tax evasion or tax avoidance takes place, go further than necessary for preventing tax evasion or tax avoidance and undermine the aim pursued by the Directive. None of these criteria can be considered decisive on their own – *see Leur-Bloem* (Case C-28/95).

Where the motive for a transaction is solely tax based, the benefits of the Directive may not be obtained, as "a valid commercial reason" is a concept involving more than the attainment of a purely fiscal advantage – *see Leur-Bloem* (Case C-28/95). In addition, if more objectives are involved, tax objectives may not be predominant. In this context, a valid commercial reason is not present where the cost savings resulting from restructurings and rationalizations are marginal compared to the level of tax benefits (e.g. the use of tax losses incurred by the merged company) – *see Foggia* (Case C-126/10).

However, it is not abusive under EU legislation to structure the transaction in the most tax-beneficial way if sound commercial reasons are available – *see Eurowings* (Case C-294/97).

Nevertheless, the benefits of the Directive may not be denied if the main purpose of a merger is the avoidance of a tax that is not covered by this Directive. In this sense, the anti-abuse rule does not cover transactions which, although primarily undertaken for tax purposes, aim at avoiding a tax that does not fall within the scope of the Directive – *see Zwijnenburg v. Staatssecretaris van Financiën* (Case C-352/08).

Cross-border reorganizations may lead to cases of double taxation where one Member State considers a transaction legitimate (therefore allowing the transaction to take place based on book values), while another Member State considers the same transaction abusive (as a result of which a deferral of tax is not granted). Under such circumstances, the applicable tax treaty (if any) or the Arbitration Convention (90/436) may oblige the Member States concerned to avoid the double taxation.

3.4. *Anti-Tax Avoidance Directive*

On 21 July 2016, the Anti-Tax Avoidance Directive (2016/1164) (ATAD) was adopted. This Directive, which applies to all taxpayers subject to corporate income tax (including permanent establishments in Member States of companies based in third countries), contains anti-avoidance rules such as (i) a limitation on the deduction of interest expense; (ii) exit taxes; (iii) a general anti-abuse rule; (iv) controlled foreign company (CFC) rules; and (v) hybrid mismatch rules.

The ATAD was amended by Amending Directive to the 2016 Anti-Tax Avoidance Directive (2017/952) (ATAD 2) – adopted by the Council on 29 May 2017 – to address hybrid mismatches involving third countries. Member States had to implement ATAD 2 by 31 December 2018, which was extended to 31 December 2019 for the implementation of the exit tax provisions and hybrid mismatches, and to 31 December 2021 for reverse hybrid mismatches. The Commission, in its business tax agenda for the 21st century, has stated that it aims to tackle the abusive use of shell companies through a new directive (ATAD 3 – for details, *see* section 3.5.).

On 19 August 2020, the Commission adopted the first report on the implementation of the ATAD, which included an overview of the implementation of the inter-

est limitation, and general anti-abuse and CFC rules across Member States (COM(2020)383 final).

By 1 January 2023, almost all Member States had implemented the ATAD's rules, except for some countries that already had similar provisions in place under their domestic law. Member States that have not implemented the ATAD rules because a corresponding rule already existed are:
– regarding the interest limitation rule: Germany, Slovenia and Spain (which plans to transpose the ATAD rules during 2023);
– regarding the exit taxation rule: France and Germany;
– regarding the GAAR: Belgium, Bulgaria, Finland, Germany, Ireland, Italy, Latvia, the Netherlands and Spain; and
– regarding the CFC rule: France and Germany.

The hybrid mismatch rules of ATAD 2 have been implemented by all Member States with the exception of Lithuania, whose rules regarding reverse hybrids with third countries take effect from 2023.

3.4.1. Interest limitation rules

Interest limitation rules, under which net borrowing costs in a taxable period, are only deductible up to the higher of (i) 30% of the taxpayer's earnings before, interest, tax, depreciation and amortization (EBITDA); or (ii) EUR 3 million. Member States can allow a full deduction of interest expenses for standalone entities.

The net borrowing costs are equal to the interest expenses, economically equivalent costs and costs incurred for the raising of finance less taxable interest income and economically equivalent income.

Member States may allow companies belonging to a consolidated group for financial accounting purposes to calculate their deductible expenses using group ratios. Accordingly, companies showing that their equity over asset ratio is equal to or higher than the equivalent group ratio may also fully deduct the interest. This is deemed to be the case if the equity over asset ratio is not more than 2% lower than the equivalent ratio of the worldwide group and all assets and liabilities are valued using the same method.

Alternatively, Member States may allow a higher deduction calculated in two steps. First, the group ratio must be determined by dividing the excess borrowing costs towards third parties by the group EBITDA. Thereafter, the group ratio must be multiplied with the EBITDA of the company concerned.

With respect to non-deductible interests, Member States may introduce carry-forward and carry-back possibilities for an unlimited period or a maximum of 3 years, respectively. With respect to unused interest capacity, Member States can also opt to implement a carry-forward provision for a maximum of 5 years.

Member States may exclude financial undertakings from the scope of these rules, even where such financial undertakings are part of a consolidated group for financial accounting purposes. Excess interest expenses incurred on loans which were concluded before 17 June 2016 and loans used to fund certain long-term public infrastructure projects can also be excluded.

Member States that have sufficient special target rules may postpone the implementation of the interest limitation rule until 1 January 2024.

3.4.2. Exit taxes

The exit tax rules cover certain cross-border transfers of assets or residence of companies to EU or non-EU countries. The following transactions are taxed:
– transfer of assets from the head office to a permanent establishment located in another Member State or in a third country to the extent that the Member State of the head office no longer has the right to tax the transferred assets;
– transfer of assets from a permanent establishment in a Member State to its head office or another permanent establishment located in another Member State or third country;
– transfer of the tax residence of a company to another Member State or third country, unless the assets remain connected with a permanent establishment in the Member State of origin; and
– transfer of the business carried out in a permanent establishment to another Member State.

In the aforementioned cases, the difference between the fair market value of the assets and the tax value is taxed.

Besides immediate taxation, Member States must also provide for the possibility to defer the payment to five instalments in the event of transfers to Member States or third countries that belong to the EEA and that concluded an agreement equivalent to the Recovery Directive (2010/24). Interest may be charged on deferred exit tax and the deferral may be subject to guarantee arrangements in the case of demonstrable and actual risk of non-recovery to ensure proper tax collection. The deferral of payment can be immediately discontinued and the tax debt can become recoverable under certain circumstances (e.g. transfers to third countries or bankruptcy of the taxpayer).

Certain temporal transfers of assets are excluded from these provisions (e.g. assets related to the financing of securities, collaterals, capital requirements or liquidity management).

A step-up rule is introduced for certain taxable transactions between Member States. Accordingly, Member States must accept the exit value established by the Member State of origin unless the exit value does not reflect the market value under certain circumstances.

3.4.3. General anti-abuse rule (GAAR)

Under the GAAR, non-genuine arrangements or series thereof with the main purpose or one of the main purposes of obtaining a tax advantage which is against the object or purpose of the applicable law are ignored for the purposes of determining the corporate tax liability.

Arrangements or series thereof are regarded as non-genuine to the extent that they are not based on valid commercial reasons, which reflect economic reality.

3.4.4. Controlled foreign company rules

CFC legislation applies to entities or permanent establishments that meet the following conditions:
– taxpayers holding alone or together with associated enterprises a direct or indirect participation of more than 50% of the voting rights or capital or that are entitled to more than 50% of the profits of that entity; and
– the entity or permanent establishment is subject to an effective tax rate of less than 50% of the effective tax rate that would have been charged in the Member State of the taxpayer.

The non-distributed income of a CFC must be included in the taxable income of a taxpayer. Member States may opt between the following approaches:
– inclusion of interest; dividends; income from the disposal of shares; royalties; income from financial leasing; income from banking, insurance and other financial activities; and income from invoicing associated enterprises as regards goods and services where there is no or little economic value added. In EEA situations the income does not have to be included: (i) if the CFC carries on substantive economic activities supported by staff, equipment, assets and premises; (ii) if the income of the CFC consists for one third or less of the specific types of listed income; or (iii) for financial undertakings (under conditions). This rule may be extended to third countries; or
– inclusion of non-distributed income arising from non-genuine arrangements put in place mainly to obtain a tax advantage. The included income is limited to the income attributable to the significant people functions carried out by the controlling company. Member States may introduce exceptions for CFC entities or permanent establishments with accounting profits not exceeding EUR 750,000 and non-trading income not exceeding EUR 75,000 or with accounting profits not exceeding 10% of their operating costs for the taxable period.

The income to be included under the CFC rules must be calculated in accordance with the rules of the Member State where the taxpayer resides. Double taxation relief is granted through a credit for the underlying corporate tax paid by the CFC and, in the case of profit distributions and disposals of the participation in the CFC, through the deduction of the income previously included in the tax base as CFC income from the taxpayer's taxable income.

3.4.5. Hybrid mismatches

The goal of the provisions on hybrid mismatches is to neutralize the effects of arrangements that exploit differences in the tax treatment of an entity or instrument under the laws of two or more jurisdictions.

Under the ATAD (as amended by ATAD 2), hybrid mismatches concern situations in which an entity or transaction is treated differently – for tax purposes – under the laws of two Member States (or of a third country), and this difference results in:
– a double deduction of the same payment, expense or loss; or
– a deduction of a payment without the inclusion of the corresponding income for tax purposes in the payee jurisdiction.

The hybrid mismatches covered by the ATAD are related to entities, financial instruments and permanent establishments. Specifically, the ATAD covers hybrid mismatches resulting from (i) payments under a financial instrument; (ii) payments to a hybrid entity, permanent establishment or a disregarded permanent establishment; (iii) payments made by a hybrid entity to its owners; (iv) deemed payments between the head office and permanent establishment or between two or more permanent establishments; and (v) payments made by a hybrid entity or a permanent establishment. Additionally, the ATAD includes specific rules for dealing with dual residence mismatches, hybrid transfers, imported mismatches and reverse hybrid mismatches.

The personal scope of application of the provisions is restricted to payments between associated enterprises, between permanent establishments and their head offices and payments made under structured arrangements.

The ATAD establishes primary and secondary rules under which mismatches are neutralized by one Member State. For example, when the mismatch results in a double deduction, the Member State of the investor must deny the deduction. Failing this, the deduction must be denied in the Member State of the payer jurisdiction.

3.4.6. Impact on investment funds

The impact of the ATAD on investment funds may be limited. In particular, the ATAD contains an option for Member States to exclude financial undertakings from application of certain anti-avoidance rules to prevent that, amongst others, investment banks are adversely impacted. Specifically, the interest limitation rule and the CFC rules do not apply to financial undertakings.

For banks, there is an exception to the hybrid mismatch provisions for financial instruments. Until 31 December 2022, Member States could exclude certain financial instruments (from banks) from this regime. These included so-called "contingent convertibles" (CoCo's), which are a mixture of equity and debt and are widely used by banks to meet Basel III capital requirements. However, this exception did not give Member States a carte blanche: point 17 of the preamble to ATAD 2 states that the scheme is without prejudice to the rules on State aid.

The reverse hybrid rule does not apply to collective investment vehicles with a diversified securities portfolio that are subject to financial supervision. Qualifying investment vehicles for the exception are (i) those referred to in article 1 of the UCITS Directive (2009/65); and (ii) alternative investment funds referred to in article 4(1)(k) of the Alternative Investment Fund Managers Directive (2011/61), as well as Regulations (EC) 1060/2009 and (EU) 1095/2010. Such collective investment undertakings will therefore not be affected by the reverse hybrid measure. However, this does not mean that the other hybrid mismatch provisions do not apply to such investment funds.

3.5. *Misuse of shell entities*

The Commission, as part of its business tax agenda for the 21st century for 2021-2023 (COM(2021) 251 final), launched an initiative to tackle the abusive use of shell companies to ensure that legal entities without a substantial business presence do not benefit from tax advantages. The Commission issued a proposal for a Council directive on 22 December 2021 ("ATAD 3") and opened a feedback period which ran from 23 December 2021 to 6 April 2022.

Through the use of objective indicators related to income, personnel and premises, the proposed directive aims to establish transparency standards in relation to the use of shell entities, in order to allow tax authorities to detect and prevent misuse of such entities for tax purposes and deny them certain tax benefits.

As an advisory body in this procedure, the European Parliament adopted its report on ATAD 3 proposal on 17 January 2023 (COM(2021)0565 – C9-0041/2022 – 2021/0434(CNS))). The report is not legally binding for the ECOFIN but it should be taken into account while discussing and voting on the proposal.

3.6. *Global minimum taxation*

EU Member States approved the Minimum Taxation Directive (2022/2523) on 15 December 2022 to implement the OECD Pillar Two Global Anti-Base Erosion (GloBE) rules. The Minimum Taxation Directive was published in the Official Journal of the European Union on 22 December 2022 (ST/8778/2022/INIT, OJ L328 (2022)).

The Minimum Taxation Directive aims to ensure that large groups in the European Union pay a minimum tax rate in every jurisdiction in which they operate. It provides for a minimum effective tax rate of 15% for domestic and international groups with a consolidated group revenue of more than EUR 750 million a year during two of the last four tax periods, and with either a parent company or a subsidiary situated in an EU Member State. If the group is not taxed at such a minimum effective rate on a jurisdictional basis, a top-up tax is triggered to reach the 15% minimum effective tax rate.

Entities and their permanent establishments may be deemed as a group in light of ownership or control ties that determine the obligation to prepare consolidated accounts as a single unit (consolidation on a line-by-line basis). Public entities, international organizations, non-profit organizations, pension funds, as well as investment funds and real estate investment vehicles when they control a group, are excluded from the scope, as well as the instrumental entities of the excluded company. Domestic groups also fall within the scope of the Directive.

Calculation of the top-up tax

Where the effective tax rate (ETR) for the entities in a particular jurisdiction is below 15%, the group must pay a top-up tax to bring its rate up to 15%. The ETR is calculated as the ratio of the aggregate amount of covered taxes paid in a jurisdiction to the aggregate amount of qualifying income in each jurisdiction. The amount of qualifying income is based on consolidated accounting results, as a starting point, with specific GloBE adjustments (e.g. exclusion of dividends from certain portfolios, timing differences, exclusion of shipping income).

In the application of a substance-based carve-out, the calculation of qualifying income is reduced by an amount equal to 5% of the value of tangible assets and 5% of payroll that the group employs in the jurisdiction (with a 10-year transitory regime with increased carve-out percentages).

The amount of covered taxes does not include indirect taxes, payroll and property taxes. It is calculated from the accounting tax expense with specific GloBE adjustments.

Allocation rules of the top-up tax

The Minimum Taxation Directive provides two rules for allocating the top-up tax:

- an income inclusion rule (IIR) in accordance with which a parent entity of a multinational enterprise (MNE) group or of a large-scale domestic group computes and pays its allocable share of top-up tax in respect of the low-taxed constituent entities of the group; and
- an undertaxed profit rule (UTPR) in accordance with which a constituent entity of an MNE group has an additional cash tax expense equal to its share of top-up tax that was not charged under the IIR in respect of the low-taxed constituent entities of the group. The allocation of tax under the UTPR is based on the number of employees and tangible assets in the relevant jurisdiction.

Taxpayers

The Directive establishes the following types of taxpayers based on a top-down approach:

- Ultimate parent entities, which are located in the European Union, incur the primary obligation to apply the IIR to their allocable share of top-up tax relating to all low-taxed constituent entities of the MNE group, whether they are located in or outside the European Union. In the case of domestic groups, the ultimate parent entity must apply the IIR to the entire amount of top-up tax.
- Intermediate parent entities located in the European Union must apply the IIR up to their allocable share of the top-up tax when the ultimate parent entity is an excluded entity or is located in a third-country jurisdiction that has not implemented the OECD Model rules or equivalent rules.
- Partially owned parent entities located in the European Union that are more than 20% owned by interest holders outside the group are obliged to apply the IIR up to their allocable share of the top-up tax, regardless of whether the ultimate parent entity is located in a jurisdiction that has a qualified IIR (unless they are wholly owned by another partially owned parent entity which is required to apply the IIR).
- Other entities located in the European Union must apply the UTPR to any residual amount of top-up tax that has not been subject to the IIR and the top-up tax

corresponding to the ultimate parent entity which is located in low-taxed jurisdictions.

Special rules apply for restructuring transactions and the transfer of assets. CFC rules and distribution regimes are also specifically treated.

Qualified domestic top-up tax

The Directive allows EU Member States to exercise the option to apply a domestic top-up tax to low-taxed domestic subsidiaries. This option will allow the top-up tax due by the subsidiaries of the multinational group to be charged locally, within the respective Member State, and not at the level of the parent entity.

Exclusions

A transitory exemption applies for MNE groups that are at the initial phase of their international activity for a period of 5 years, provided that the MNE group does not have constituent entities in more than six jurisdictions and the value of all assets of the group located outside the Member State does not exceed EUR 50 million. Domestic groups can also be excluded for a transitional period of 5 years under the same conditions.

The rules also provide for an exclusion of minimal amounts of income to reduce the compliance burden. According to the *de minimis* exclusion, no top-up tax will be charged when average revenues are less than EUR 10 million and an average qualifying income (or loss) is less than EUR 1 million in a jurisdiction.

Additionally, Member States in which very few groups are headquartered (i.e. less than 12 ultimate parent entities of groups within the scope of this Directive are located in the jurisdiction) have the option to not apply the IIR and the UTPR for 6 years. The election for the delayed application of the rules must be notified to the European Commission by 31 December 2023.

Transposition deadlines

Member States must bring into force the laws, regulations and administrative provisions necessary to transpose the Directive by 31 December 2023, with the exception of the UTPR for which the transposition deadline is 31 December 2024.

Importance of OECD works

The Directive refers to the OECD Model rules and the explanations and examples in the Tax Challenges Arising from the Digitalisation of the Economy – Commentary to the Global Anti-Base Erosion Model Rules (Pillar Two) released by the OECD/G20 Inclusive Framework on BEPS, as well as the GloBE Implementation Framework, including its safe harbour rules, as a source of illustration or interpretation in order to ensure consistency in application across Member States of the Minimum Taxation Directive.

The OECD continues working on the implementation package. On 15 December 2022, the Inclusive Framework on BEPS agreed on a minimum transitional safe harbour based on the CbC reporting information to exclude operations in lower-taxed jurisdictions provided that in the jurisdiction (i) the *de minimis* exclusion applies; (ii) the ETR (calculated on a simplified basis) is at least 15% (16% for 2025 and 17% for 2026); or (iii) the pre-tax profit is less than the amount resulting from the substance-based exclusion. A transitional penalty relief regime, which requires careful consideration by tax authorities for applying penalties or sanctions where an MNE has taken reasonable measures to ensure the correct application of the GloBE rules, was also approved. Together with this publication, the OECD launched a public consultation on the GloBE information return and dispute prevention and resolution mechanisms which will run until 3 February 2023.

On 1 February 2023, additional Agreed Administrative Guidance on the model rules was approved by the OECD Inclusive Framework on BEPS.

3.7. *Debt-equity bias reduction allowance*

The Commission, as part of its business tax agenda for the 21st century for 2021-2023 (COM(2021) 251 final), launched an initiative to address the debt-equity bias in corporate taxation through a debt-equity bias reduction allowance (DEBRA) (i.e. an equity allowance). To this end, the Commission issued a proposal for a Council directive on 11 May 2022 (COM(2022) 216 final) and opened a feedback period which ran from 13 May until 8 July 2022.

In short, the DEBRA initiative proposes:

– an allowance on equity of up to 30% of the taxpayer's EBITDA – for a period of ten consecutive tax periods – with carry-forward for excesses and unused capacity. This allowance will reduce the corporate income tax base. The allowance is calculated by applying a notional interest rate to the allowance base, which is the difference between the net equity at the end of a tax period and the net equity at the end of the preceding tax period; and
– that 15% of the exceeding borrowing costs (i.e. interest paid minus interest received) is non-deductible.

The European Economic and Social Committee (EESC) has recommended to include an exclusion from the rules for SMEs and micro-enterprises on the grounds that the proposed measures could make EU companies financially weaker and hamper investment, growth and job creation in the European Union (ECO/595-EESC-2022).

The ECOFIN suspended work on DEBRA in light of the many interlinkages with other corporate tax dossiers, e.g. ATAD 3 (*see* section 3.5.), the Minimum Taxation Directive (*see* section 3.6.) and BEFIT (*see* section 3.8.), which are currently under discussion in the Council (*see* Report to the European Council on tax issues (14905/22 LIMITE FISC 227 ECOFIN 1177), as approved on 6 December 2022).

3.8. *Common (consolidated) corporate tax base*

In 2016, the Commission launched a proposal to achieve a CCCTB for Member States (COM(2016) 685 final) in two stages. The first step would be the introduction of a common corporate tax base (CCTB). The second step

would involve a move towards a consolidation regime for EU group companies – a CCCTB. The proposal was based on a previous directive proposal launched in 2011 (COM(2011) 121 final).

The Commission plans to present, by the third quarter of 2023, a single corporate tax rulebook for the European Union (the "Business in Europe: Framework for Income Taxation" or BEFIT). According to a letter of 3 August 2021 that was addressed to the European Parliament (No. E-002742/2021), the BEFIT will build on some of the fundamental elements of the OECD/G20 global agreement, which introduces a two-pillar solution towards addressing the tax challenges arising from the digitalization of the economy. It will operate in a similar context, as it addresses cross-border issues linked to the taxation of groups of companies, and will be based on a formulary apportionment and a common tax base. It will replace the pending proposal for a CCCTB. The European Commission has announced its intention to publish the BEFIT proposal as part of the Commission Work Programme 2023 adopted on 18 October 2022 (COM(2022) 548 final). It opened a feedback and consultation period, which ran from 13 October 2022 until 26 January 2023. According to the initiative, the European Commission is evaluating different policy options as regards the scope of the measure, the tax base calculation, the basis for an apportionment formula among EU Member States, allocation rules for related entities outside the European Union and administration.

More specifically, the policy options include, for example:
– as regards the scope: to limit the proposal to groups with consolidated global revenues exceeding EUR 750 million, or to also include SMEs with cross-border activities;
– as regards the tax base: to require the use of standardized financial statements (with a limited list of tax adjustments) or the set-up of a comprehensive corporate tax system (with detailed rules for all aspects of profit and tax determination); and
– on the allocation formula: to consider only tangible assets, labour and sales by destination as factors, or to also incorporate intangible assets as a factor.

The CCTB proposal

The 2016 CCTB proposal suggests a corporate tax base for EU companies that would be mandatory for large multinational groups with global consolidated revenues exceeding EUR 750 million per year. Other groups of companies can opt into the regime for a period of 5 years (automatically renewed until a notice of termination is given). Companies that do not opt in will remain subject to the (existing) national laws of the territory in which they are resident. The rules will not apply to shipping companies under a special tax regime.

The proposal sets out a number of rules for calculating the tax base under the CCTB. Broadly, all revenues (which include proceeds of sales, proceeds from the disposal of assets and other profit distributions) will be taxable, with some adjustments. The proposal includes, inter alia:
– a list of non-deductible expenditures (e.g. fines and penalties, bribes, distributions, entertainment and capital costs);
– rules for dealing with provisions, bad debts, hedging arrangements, as well as transitional rules where companies enter and leave the CCTB regime;
– transfer pricing provisions through which transactions between a taxpayer and its associated enterprise(s) should be subject to pricing adjustments in line with the arm's length principle;
– depreciation rules for fixed assets (including intangible fixed assets, commercial buildings and industrial buildings) that can be depreciated on a straight-line basis over their defined useful life. Intangible fixed assets (e.g. intellectual property) will be depreciated over the period (i) for which the assets enjoy legal protection; or (ii) for which the rights have been granted. Where this cannot be determined, a default period of 15 years will apply;
– a participation exemption for chargeable gains on the disposal of shares where the taxpayer has held at least 10% of the capital or voting rights for 12 months leading up to the disposal – this rule will apply to both trading and investment companies;
– an exemption for distributions received, although a minimum holding of 10% of the capital or voting rights is required which must be held for 12 consecutive months. Life insurance undertakings and companies holding shares for trading will not be able to benefit from the exemption;
– an allowance for equity that will allow businesses to deduct a notional yield on equity increases. Where there is a reduction in the amount of equity, the yield calculated thereon will constitute taxable income (*see also* section 3.7. for the 2021 debt-equity bias reduction allowance (DEBRA) initiative launched by the Commission); and
– a foreign permanent establishment exemption.

The CCTB does not contain any provisions to allow for a beneficial IP regime, such as a patent box which is seen in a number of Member States (e.g. France, Italy, the Netherlands and Spain). However, the proposal includes an enhanced deduction for expenditure on R&D. R&D costs are fully expensed in the year incurred. Businesses may claim an additional 50% deduction for R&D expenditure up to EUR 20 million and an additional 25% on costs exceeding that figure. Small, stand-alone entities that are less than 5 years old can potentially claim a 100% extra deduction on R&D expenditure up to EUR 20 million.

The proposal also includes anti-avoidance rules to tackle loopholes associated with profit-shifting for tax purposes (e.g. an interest deduction limitation rule, exit tax rules, a general anti-avoidance rule, CFC rules, hybrid mismatch rules and a switchover provision). The rules have some differences from those implemented under the ATAD (e.g. the minimum amount for the interest limitation rules is set at EUR 3 million and a group ratio rule is not included).

An indefinite carry-forward of tax losses is available, but no carry-back of losses is possible. The proposal includes provisions to prevent losses from being used where there has been a change in ownership and a major change in activity.

The CCTB proposal provides for a limited current year sharing of losses within the European Union. Losses would only be available to the direct parent (or head office of a permanent establishment) and would be recaptured as the subsidiary or permanent establishment starts to make profits. After 5 years, all remaining losses claimed will be recaptured. These rules would apply until the CCCTB is implemented, as the latter proposes EU-wide group consolidation of income and losses.

The CCCTB proposal

Under the CCCTB, taxable profits of companies of different Member States and permanent establishments situated in the European Union of a group would be determined on the basis of a common tax base under certain conditions. The consolidated results of the group (i.e. the sum of the tax bases of the constituent members of the group and elimination of intra-group transactions) would be allocated among the Member States by way of an allocation formula based on different (production) factors – so-called formulary apportionment.

These factors are (i) the proportion of sales; (ii) employees – whereby both payroll costs and number of employees are considered; and (iii) the assets situated in each Member State, whereby intangibles and financial assets are excluded. Each factor carries equal weight (i.e. 33.33%).

Each Member State would then apply its own national tax rate to the profit allocated to it under the formula.

The Member State in which the parent company of the consolidated group is resident would undertake the administrative aspects, including tax audits (which may take place at the request of a competent authority in another Member State). The consolidated tax return and supported documentation filed by the principal taxpayer will be stored in a central database to which competent authorities in all Member States will have access.

3.9. *Other developments*

Code of conduct list of preferential tax regimes

The Code of Conduct Group (Business Taxation) regularly publishes an overview of preferential tax regimes in (i) the European Union; (ii) dependent or associated territories of Member States to which EU treaties do not apply; and (iii) other jurisdictions.

On 8 November 2016, the ECOFIN set out criteria for screening jurisdictions with the purpose of establishing an EU list of non-cooperative jurisdictions (14166/16). The ECOFIN agreed on a Revised Code of Conduct for Business Taxation on 8 November 2022 (14452/22 FISC 214 ECOFIN 1131) which broadened the scope of the tax measures under scrutiny and clarified the review process in the Code of Conduct Group.

The screening focuses on the following three areas:

– tax transparency: implementation of, or commitment to, exchange of information under various standards, e.g. the Common Reporting Standard, OECD Exchange of Information on Request and the OECD Multilateral Convention on Mutual Administrative Assistance;
– fair taxation: the existence of harmful preferential regimes, the facilitation of offshore structures and arrangements attracting profits that do not reflect real economic activity in the jurisdiction and, from 2022, tax features of general application which can be considered as harmful if they lead to double non-taxation or the double/multiple use of tax benefits; and
– implementation of BEPS measures: implementation of, or commitment to, the agreed OECD anti-BEPS minimum standards.

Jurisdictions that, after screening, do not meet all three criteria are placed on the list of EU non-cooperative jurisdictions. The list, first adopted on 5 December 2017, is updated at least once a year and currently contains the following jurisdictions (with effect from 4 October 2022): American Samoa, Anguilla, Bahamas, Fiji, Guam, Palau, Panama, Samoa, Trinidad and Tobago, the Turks and Caicos Islands, the US Virgin Islands and Vanuatu.

Countries taken off the non-cooperative list may be moved to a separate category of jurisdictions subject to close monitoring (“grey list”).

Recent initiatives

The Commission has released, as part of its business tax agenda for the 21st century for 2021-2023 (COM(2021) 251 final), a set of new initiatives that includes a debt-equity bias reduction allowance (DEBRA, *see* section 3.7.) and rules to tackle the abusive use of shell companies to ensure that legal entities without a substantial business presence do not benefit from tax advantages (ATAD 3, *see* section 3.5.). Also part of this initiative is the introduction of a requirement for certain large companies operating in the European Union to publish their effective tax rates based on the methodology under discussion in Pillar Two of the OECD negotiations by 2022.

During 2022, the Commission has released new initiatives to:

– improve withholding tax procedures for non-resident investors that will (i) provide Member States with information necessary to prevent tax abuse in the area of withholding taxes; and (ii) improve (and swiften) requests for a refund/relief at source for any (excess) taxes withheld. To this end, the Commission launched a public consultation period that ran from 1 April 2022 to 26 June 2022. This initiative is known under the acronym FASTER (Faster and Safer Tax Excess Refund for Withholding Taxes))(for more details, *see* also section 8.1.); and
– tackle the role that enablers can play in facilitating arrangements or schemes that lead to tax evasion or aggressive tax planning involving third countries. The European Commission published a report which summarizes the contributions made by stakeholders during the feedback period (that ran from 6 July 2022 to 12 October 2022) on 31 January 2023. This initia-

tive is known under the acronym SAFE (Securing the Activity Framework of Enablers).

The European Commission plans to adopt the FASTER and SAFE proposals by June 2023.

For an overview of the initiatives to implement the OECD global agreement on the reallocation of taxing rights (Pillar One) and the Global Anti-Base Erosion (GloBE) rules (Pillar Two) at the EU level, *see* sections 5.1. and 3.6., respectively.

4. The Fundamental Freedoms and Their Impact on Direct Taxation

In relation to direct taxation, Member States retain, in principle, their sovereignty to regulate issues related to income taxation, such as the residency test, the rules on taxable base, rates, loss relief, exemptions or depreciation.

However, the exercise of this sovereignty in direct tax matters must be aligned with the principles established under EU treaties. In this regard, EU law prevents Member States from imposing rules that restrict companies in exercising their fundamental freedoms or that result in unlawful discrimination between resident and non-resident companies.

The four fundamental EU freedoms – i.e. the free movement of goods, the free movement of persons (including the free movement of EU citizens, the free movement of workers and the freedom of establishment), the freedom to provide services and the free movement of capital and payments – as well as the principle of non-discrimination, all regulated under the TFEU, form immediately applicable law and constitute individual and enforceable rights for every single individual or enterprise in the European Union (subject to the procedural requirements of national courts or the ECJ). Accordingly, in view of the fact that there has been little progress harmonizing direct taxation, the direct application of the TFEU's provisions continues to form the most important source of EU law in that area.

The ECJ has assessed the compatibility of national measures on direct taxation with EU law by determining whether:

- the domestic measure distinguishes between cross-border and internal situations;
- there is an *objective difference* between the cross-border and the internal situation that makes them comparable in light of the object and purpose of the concerned measure;
- the restriction can be *justified* by a legitimate aim (i.e. a mandatory requirement of public interest) such as the prevention of abuse or safeguarding the tax base integrity; and
- the measure's restrictive effect is *proportionate* to the legitimate aim.

For legislation to be regarded as a restriction on EU freedoms, it is sufficient to establish that such legislation *could* restrict the exercise of the freedom(s) in question in a Member State by companies established in another Member State, without having to establish that the legislation in question has *actually* restricted that (those) EU freedom(s).

The sections below summarize the ECJ's conclusions on the most relevant aspects related to corporate and individual taxation.

4.1. *Corporate taxation*

4.1.1. Treatment of cross-border transactions

Member States generally provide some reliefs to mitigate or eliminate juridical and economic double taxation that can arise from cross-border investments.

In some cases, the Parent-Subsidiary Directive (2011/96) and the Interest and Royalties Directive (2003/49) regulate such relief mechanisms (*see* sections 3.1. and 3.2.). In cases not falling within the scope of these (or other) Directives, such relief mechanisms may be limited, by domestic rules, to resident recipients or domestic income.

Domestic rules under both cases must be compatible with EU freedoms. EU law provides for:

- home state neutrality, i.e. the right not to be hindered to earn income abroad (national tax treatment of foreign-source income should not be less advantageous than that applied to resident taxpayers deriving similar income from domestic sources); and
- host state neutrality, i.e. equal treatment of non-residents and residents as regards their tax base.

Home state neutrality: Taxation of resident companies receiving foreign-source income

In general terms, resident companies receiving foreign-source income should be treated the same way as resident companies receiving domestic income, provided they are in an objectively comparable situation. This applies unless the disparate treatment is justified by an overriding reason of public interest. For example, legislation of a Member State under which certain reliefs aimed at mitigating the risk of double taxation do not apply where the income arises from foreign sources is often found incompatible with EU law.

Member States are free to choose a method for avoiding a series of charges to tax. For example, the method to relieve double taxation may be different for domestic dividends (exemption method) than it is for inbound foreign dividends (credit method). This is not an issue as long as the latter are not treated less favourably than the former. As both categories of dividends are comparable as concerns the risk of economic double taxation, a Member State must mitigate such double taxation on inbound foreign dividends to the same extent as it does for domestic dividends. Accordingly, the tax rate applied to foreign-source dividends cannot be higher than the rate applied to nationally-sourced dividends, and the tax credit granted should be at least equal to the amount paid in the Member State of the company making the distribution – *see FII Group Litigation* (Case C-446/04) and *CFC and Dividend Group Litigation* (Case C-201/05).

In this regard, allowing full neutralization for the add-back of a proportion of costs and expenses (equal to 5% of the net dividends received) only for group domestic

subsidiaries but not for foreign subsidiaries – *see Groupe Steria* (Case C-386/14) – is incompatible with the freedom of establishment.

Likewise, denying a carry-forward of credit to subsequent years (when the company receiving dividends has recorded an operating loss for the year in which it received the foreign-source dividends), while a resident company can carry-forward losses and apply an exemption to domestic dividends – *see Haribo and Salinen* (Case C-436/08) – is incompatible with the free movement of capital. The refusal to grant a tax credit to resident shareholders receiving domestic-source dividends, where those dividends originated from foreign-source profits – *see The Trustees of the BT Pension Scheme* (Case C-628/15) – is also in breach of the free movement of capital. Also, Member States cannot provide a tax advantage exclusively with respect to dividends attached to shares listed on the stock exchange of that Member State while denying dividends attached to shares listed on foreign stock exchanges such an advantage – *see Real Vida Seguros* (Case C-449/20).

Further, applying an exemption and allowing for the set off of withholding tax against corporation tax payable for resident investment companies and non-resident investment companies with a permanent establishment in the Member State, while disallowing non-resident investment companies with no permanent establishment in the Member State this same treatment – *see Commission v. Belgium* (Case C-387/11) – constitutes unlawful restrictions of both the freedom of establishment and the free movement of capital.

The application of the credit system to foreign dividends can imply administrative burdens that fall on the taxpayer. In this regard, Member States are allowed to require evidence with regard to foreign-source dividends, insofar as that evidence is not (virtually) impossible or excessively difficult to obtain – *see Accor* (Case C-310/09). Possible justifications for imposing this administrative burden include ensuring the effectiveness of fiscal supervision and combating tax avoidance.

In particular, Member States can make relief for foreign-source dividends contingent on the existence of a treaty containing an exchange of information clause with the source state – *see A* (Case C-101/05); *Pharol, SGPS, SA v. Autoridade Tributária e Aduaneira* (C-67/22). However, requiring an agreement for mutual assistance not only at the administrative level but also with regard to enforcement can be deemed disproportional – *see Haribo and Salinen* (Case C-436/08). In the same way, legislation of a Member State that makes the application of a tax credit conditional upon the provision of a specific tax certificate, without any opportunity for the shareholder to prove, by means of other factors and relevant information, payment of the tax, is also disproportional – *see Meilicke II* (Case C-262/09).

Member States cannot require that the application of a participation exemption to foreign dividends be dependent on the condition that the distributing entity derives its gross profits from active business activities while not requiring the same from domestic-source dividends. Such a requirement cannot be justified based on the need to prevent tax avoidance (as it does not specifically target conduct involving the creation of wholly artificial arrangements that do not reflect economic reality, but provides for an irrebuttable presumption of abuse merely because dividends are distributed out of profits derived from passive income) – *see EV* (Case C-685/16).

Similarly, Member States cannot reject the deduction of the interest paid to an associated company that resides in another Member State on the ground that the principal reason for the debt is for the group to receive a substantial tax benefit, and such tax benefit would not have been deemed to exist if both companies had been resident in the first Member State – *see Lexel* (Case C-484/19). The legislation at issue enables tax authorities to deny the deductibility of interest expenses even in cases where the interest is at arm's length and the transactions are conducted for commercial reasons. By contrast, Member States are not required to grant a credit for the withholding tax levied on foreign portfolio dividends to prevent juridical double taxation – *see Haribo and Salinen* (Case C-436/08). In this regard, juridical double taxation arising from the parallel exercise of tax competences by different Member States is not contrary to EU law – *see Damseaux* (Case C-128/08). Furthermore, Member States are not obliged to grant a refund for the tax paid by the distributing company at the level of the parent company where the tax is paid in the other Member State – *see Kronos International* (Case C-47/12).

Member States can also restrict a refund of foreign dividend withholding tax granted to the resident parent company, to the amount that the latter could have credited on the basis of a tax treaty. Having regard to the disparities between the Member States' systems of taxing distributed profits, a Member State may treat, by treaty or unilaterally, dividends from various Member States differently. In this context, a most favoured nation treatment under EU law is not required. Member States may also limit the credit granted for foreign withholding taxes to the amount of tax that would have been imposed in dividends paid between resident companies – *see Société Générale* (Case C-403/19). However, reducing the amount of the refund to the extent to which the shareholders are residents of other Member States or third countries is incompatible with the free movement of capital, as the reduction adversely affects all the shareholders of those enterprises without distinction – *see Orange European Smallcap Fund* (Case C-194/06).

Host state neutrality: Taxation of foreign companies receiving domestic-source income

Generally speaking, the state of the payor (i.e. the host state) should ensure that non-resident recipients and resident recipients are treated equally, to the extent that they are in a comparable situation. In these cases, a comparable situation is generally deemed to exist if non-resident recipients are subject to host state taxes. Accordingly, a tax imposed by the host state only on outbound dividends, or a relief from economic double taxation only available to resident shareholders, could be found incompatible with EU law if the non-resident shareholder is also subject to tax on those dividends in the host state.

It follows from this that Member States are not obliged to extend to non-resident parent companies a tax credit that is granted upon distribution of dividends to resident parent companies for the underlying corporate tax, if the

non-resident parent companies are not taxed on such dividend income in that Member State. Member States are also free to differentiate between various Member States depending on the provisions of tax treaties, as well as to refuse treaty benefits in cases where the outbound dividends would flow to third Member States – *see ACT Group Litigation* (Case C-374/04).

On the contrary, when a Member State extends its taxing power to dividends received by non-resident parent companies, these companies and resident parent companies are in a comparable situation as concerns the risk of economic double taxation on dividends received from that Member State. Hence, when it does not levy withholding taxes on dividends paid to resident parent companies, the source state must grant the same or similar treatment to non-resident companies to avoid economic double taxation – *see Denkavit II* (Case C-170/05) and *Amurta* (Case C-379/05). The same applies as regards companies resident in other EEA countries – *see Commission v. Netherlands* (Case C-521/07).

In particular, legislation that imposes a withholding tax on dividends paid to an investment company resident in another Member State but exempts dividends paid to a resident parent company or resident investment fund, is incompatible with the EU freedom of establishment. Differences in legal form of the funds or the fact that the income of the investment company was not taxed in the other Member State does not make the situation incomparable. Such a restriction cannot be justified by the prevention of tax avoidance, as the measure does not specifically target wholly artificial arrangements lacking economic reality, designed to circumvent the legislation of the Member State concerned – *see Aberdeen* (Case C-303/07).

Likewise, national tax legislation that exempts dividends received by resident pension funds operating in accordance with domestic regulations, while taxing dividends received by non-resident pension funds, infringes the free movement of capital and contravenes EU and EEA law – *see Commission v. Portugal* (Case C-493/09), *Commission v. Finland* (Case C-342/10) and *College Pension Plan of British Columbia* (Case C-641/17). The same applies to withholding taxes imposed on dividends paid to non-resident undertakings for collective investment in transferable securities (UCITS) – *see Santander Asset Management SGIIC and Others* (Case C-338/11) and *AllianzGI-Fonds AEVN* (Case C-545/19) – or to other investment funds resident in third countries if such states have a mutual administrative assistance agreement that permits the exchange of information – *see Emerging Markets Series* (Case C-190/12).

The restriction could be justified by the aim to safeguard the cohesion of the tax system if the legislation makes the tax exemption available to resident funds contingent on a minimum distribution to investors (which in turn is subject to withholding tax). In this case, the exemption granted to resident funds is offset by the subsequent taxation of the distribution to their investors. Nevertheless, the restriction would be contrary to EU freedoms if it goes beyond what is necessary to safeguard the coherence of the tax system – *see Fidelity Funds* (Case C-480/16). Similarly, the inability of a non-resident investment fund to reclaim a withholding tax levied in a Member State on the grounds that it does not comply with the distribution requirement applicable to funds registered in that Member State may be contrary to the free movement of capital if both situations are comparable – *see Köln-Aktienfonds Deka* (Case C-156/17).

On similar grounds, a withholding tax on interest paid to non-residents can form a restriction that is justified by an overriding reason in the general interest and does not go beyond what is necessary to attain the objective pursued. A Member State may postpone the application of a deduction at a later stage following a refund application – *see Viva Telecom Bulgaria* (Case C-257/20). A Member State may not, however, categorically deny the deduction of expenses to non-residents as it cannot a priori be ruled out that a non-resident is able to provide relevant evidence enabling the tax authorities of the Member State of taxation to ascertain, clearly and precisely, the nature and genuineness of the business expenses in respect of which deduction is sought – *see Brisal* (Case C-18/15).

Also, a restriction cannot be justified by the balanced allocation of taxation powers between Member States or the need to ensure the effective collection of taxes, in cases where a withholding tax on dividends paid to a resident company only applies if the company is profitable – resulting in deferred taxation or even non-taxation (if the company ceases to exist) – while applying unconditionally to dividends paid to a non-resident company. The exclusion of such cash-flow advantage in cross-border situations constitutes a restriction on the free movement of capital – *see Sofina and Others* (Case C-575/17). Likewise, Member States cannot limit a tax exemption to non-resident investment funds constituted in accordance with contract law while denying that benefit to similar, non-resident investment funds constituted in accordance with a statute – *see A SCPI v. Veronsaajien oikeudenvalvontayksikkö* (Case C-342/20). The balanced allocation of taxation powers between Member States cannot justify the taxation of recipient companies established in another EU Member State where an EU Member State has chosen not to tax recipient companies established in its territory in respect of dividends received – *see ACC Silicones* (Case C-572/20).

The difference in treatment can also not be justified by the existence of a tax treaty if dividends are not taxed at all or are taxed at a lower rate in the state of residence of the receiving company. In this regard, the incompatibility with EU law can only be avoided if the difference in treatment is neutralized by the application of a tax treaty in those cases where the withholding tax can be set off in full against the tax due in the other state – *see Denkavit II* (Case C-170/05), *Amurta* (Case C-379/05), *Commission v. Italy* (Case C-540/07) and *Commission v. Spain* (Case C-487/08). It is for the national court to determine whether the discrimination is neutralized by the application of a tax treaty – *see Canadá* (Case C-613/18).

4.1.2. Treatment of cross-border groups

Integration in a tax consolidation regime

Member States usually grant resident companies belonging to the same group the possibility to apply for a tax consolidation regime. A tax consolidation regime allows

a pooling of the results (profits and losses) of the integrated group.

While such a regime is generally available for groups formed by resident subsidiaries and a resident parent company (vertical tax integration), Member States must also allow resident subsidiaries owned by companies established in other Member States (horizontal tax integration) to apply for the regime – *see X AB & Y AB* (Case C-200/98). A resident parent company with resident subsidiaries, whereby the latter are held indirectly through an intermediary company resident in another Member State, may also apply a tax consolidation regime to all the resident group companies – *see Papillon* (Case C-418/07) and *SCA Group Holding and Others* (Case C-39/13). Furthermore, Member States must allow a resident subsidiary of a non-resident parent company to exit a pre-existing vertical tax integration group and to integrate into a horizontal tax integration group with other subsidiaries without dissolving the pre-existing vertical tax group – *see B and Others* (Case C-749/18).

On the contrary, Member States can deny a group taxation regime to a resident parent company and its subsidiaries resident in other Member States – *see X-Holding* (Case C-337/08).

Treatment of losses in cross-border situations

Most Member States permit the domestic relief of losses within a group of companies under specific circumstances. A group of companies is treated as a single economic unit by allowing losses incurred by one company to be set off against the profits of another company of the same group.

Some Member States limit such group relief to internal situations. In general terms, EU law does not preclude domestic measures that disallow cross-border loss relief within the European Union, even if it provides for such a possibility in a purely domestic, comparable scenario.

The restriction between comparable cross-border and internal situations can be justified by a need to (i) preserve the allocation of taxing rights between Member States and prevent double relief of losses both in the Member State of the subsidiary and the Member State of the parent company; or (ii) prevent abuse, on the grounds that the transfer of a subsidiary's taxable income to a parent company carries the risk that such transfer may be organized within a group of companies to ensure that the income flows towards Member States that apply the lowest rates of taxation (or non-taxation).

However, such a national provision is not proportional to these legitimate aims (and therefore not compatible with EU law) if it does not allow the parent company to prove that its non-resident subsidiary has exhausted all possibilities of claiming loss relief in its Member State of residence and there are no possibilities of obtaining future relief, either for that EU subsidiary or for a third party – *see Marks & Spencer* (Case C-446/03) and *Commission v. United Kingdom* (Case C-172/13). It is for the national court to decide whether the exhaustion of possibilities test has been satisfied – *see Oy AA* (Case C-231/05).

Tax losses can only be regarded as final if the parent company provides evidence that it is impossible to use those losses economically. In this regard, the parent company must prove that it is impossible for a third party to use such losses in future tax periods, in particular after a sale for a price that includes the tax value of the losses – *see Memira Holding* (Case C-607/17). It is irrelevant for the purposes of assessing the finality of the losses, to which extent (i) the loss-making company was limited in carrying forward its losses; or (ii) other entities belonging to the same group located in the state of establishment of the loss-making subsidiary may have been limited in having the subsidiary's losses transferred to them – *see Holmen* (Case C-608/17).

In any case, the above conclusions only apply if the cross-border and the internal situations are objectively comparable. In this regard, the following two situations are not comparable – *see AURES Holdings* (Case C-405/18): (i) a company that is resident in a Member State incurs a loss in that Member State; and (ii) a company that transfers its place of effective management and, consequently, its tax residence to a Member State, incurs a loss in a tax year during which it was a tax resident of another Member State, without having any residual activity in the former Member State. Likewise, exempt permanent establishments of non-resident companies due to the application of a tax treaty are not in a situation comparable to that of permanent establishments resident in that EU Member State as regards measures to avoid double taxation and, accordingly, final losses of a permanent establishment are not deductible when a tax treaty applies – *see W (Déductibilité des pertes définitives d'un établissement stable non-résident)* (Case C-538/20).

Nevertheless, Member States cannot make a group loss relief subject to the requirement that the holding company's business consists wholly or mainly in the holding of shares in subsidiaries that are established in that Member State – *see ICI* (Case C-264/96). Member States are also not permitted to make a group relief conditional on being either resident or carrying out an activity through a permanent establishment in that Member State – *see Felixstowe Dock and Railway Company and Others* (Case C-80/12).

CFC legislation

As a general rule, a group company is not taxed on the profits of other companies within the group, whether resident or not, unless those other companies (being separate legal entities) are integrated in a tax consolidation regime. CFC regimes constitute an exception to this rule. Notwithstanding their purpose to prevent abuse and combat harmful tax competition, CFC rules involve a home state restriction.

As such, the taxation of a resident parent company on the profits of a subsidiary resident in another Member State, where those profits are subject in the other Member State to a lower level of taxation than that applicable in the Member State of the parent, constitutes an incompatible restriction on the freedom of establishment. This is the case unless the provision is applied only to wholly artificial arrangements intended to escape the normally due national tax. A wholly artificial arrangement does not exist where a subsidiary carries on genuine economic activities in the host Member State, even where tax motives played a role in its establishment. The taxpayer

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