Chapter 1: Concepts and Basic Principles of EU Tax Law

1.1 Concepts

European Union

The European Union (EU) is the consequence of the European integration development that started in the 1950s after the Second World War. The European Union in its present form was created by the Treaty on European Union (TEU), i.e. the Treaty of Maastricht, signed in 1992 and entered into force in 1993.

The European Union originally consisted of three pillars or sectors of cooperation. These were (1) the European Communities, (2) common foreign and security policy, and, (3) police cooperation and judicial cooperation in criminal matters.

The most relevant cooperation from the perspective of tax law has been the cooperation based on the European Communities. The European Communities were formed by the European Coal and Steel Community (ECSC), established by the Treaty of Paris signed in 1951, the European (Economic) Community (EEC), and the European Atomic Energy Community (Euratom) established by the Treaty of Rome signed in 1957. By the Lisbon Treaty, which entered into force on 1 December 2009, the European Communities were replaced and succeeded by the European Union.

TFEU

The Treaty on the Functioning of the European Union (TFEU; originally the EC Treaty) has the most relevance with respect to taxation. The TFEU is based on the Treaty establishing the European Economic Community signed in 1957 in Rome, as replaced by the Treaty of Maastricht signed in 1992 and amended by the Treaty of Amsterdam signed in 1997, the Treaty of Nice signed in 2001 and the Treaty of Lisbon signed in 2007. The TFEU entered into force on 1 December 2009.
EU tax law
EU law consists of the founding treaties (the TEU and the TFEU) and the legal provisions based on the legislative powers delegated to the European Union by the founding treaties. The part of the EU law provisions that may have an effect on taxes is referred to as EU tax law. After the entry into force of the Lisbon Treaty, the European Convention on Human Rights also became a part of EU law.

Territorial scope
EU tax law provisions limit the sovereign taxing rights of the EU Member States chiefly in situations in which the tax object or the tax subject has a connection to two or more Member States.

Besides certain exceptions, EU law provisions are relevant in relation to the whole territory of the European Union. The territorial scope of application of the EU law provisions in relation to each Member State depends on each state’s own accession agreement. For example, according to Protocol number 3 to the accession treaty of the United Kingdom, Guernsey, Jersey and the Isle of Man are not Members of the European Union, even though they are a part of the EU customs union. EU tax law does not apply to these territories.

Literature
There is substantial literature on EU tax law published in different languages of the Member States. The most important comprehensive work in English is Terra and Wattel’s *European Tax Law* (2008). Also worthy of mentioning are Easson’s *Taxation in the European Community* (1993) and Gormley’s *EU Taxation Law* (2005).

Certain international tax periodicals, such as *EC Tax Review* published by Kluwer, *European Taxation* published by the IBFD and *EC Tax Journal* published by Key Haven Publications, specialize in issues concerning EU tax law.

1.2 Relation to other legislation

1.2.1 Sovereignty and subsidiarity

Sovereignty
Despite the European Union and the Commission (the executive branch of the EU), the Member States have broad sovereignty in the area of direct taxation. The organs
of the EU do not have their own taxing powers with regard to direct taxes; however, both the EU and the Member States can make decisions concerning tax legislation. Each Member State executes its own taxing powers by domestic tax laws. Each Member State decides which are the criteria that determine the scope of direct taxation in the state concerned. The Member States may, for example, choose to apply the territoriality principle for the purposes of income taxation and to tax non-residents only on the income from sources in the country concerned. The Member States, however, must exercise their taxing powers consistently with their obligations under the founding treaties and the legislative provisions given on the basis of such treaties.

**Subsidiarity**

EU tax law provisions direct the domestic tax laws of the Member States only to the extent that it is necessary for the realization and the functioning of the internal market. The purpose of the founding treaties is not to totally harmonize the tax laws of the Member States. In accordance with the subsidiarity principle, the Union shall take action with regard to direct taxation only if and in so far as the objectives of the action cannot be sufficiently achieved by the Member States and can therefore be better achieved by the Union.

**1.2.2 Separateness and interaction**

**Legal systems of tax law**

Each EU Member State has its own national tax system. EU tax law, the tax treaties concluded by each Member State and the national tax laws of each Member State are parts of the national tax laws of the Member States. In accordance with the principle of autonomy, EU tax law, tax treaties and national tax law of each Member State are separate legal systems belonging to the national legal system of the Member State concerned. These different parts of tax law, however, are in a strong interaction with each other. For example, EU law has a substantial impact on the national tax laws of the Member States.

**No EU tax**

At present, the EU does not use direct taxes for its own recourse collecting purposes. There is no EU-level income tax and the income taxes levied in the Member States are based on the national tax provisions of each Member State’s
own domestic legislation. The tax revenue from the income taxes levied by the Member States goes directly to the Member State concerned or to a local authority thereof. The EU does not benefit directly from the tax revenue.

**Conflicts**

EU tax law, the national tax laws of the Member States and the tax treaties concluded by the Member States each has a language, concepts and provisions of its own. The provisions of EU tax law, the national tax laws and the tax treaties may therefore conflict with each other. The relationship and the primacy order among the different segments of tax law must be determined in order to determine the tax consequences in a cross-border situation.

1.2.3 The primacy of EU law

**Founding treaties**

Unlike indirect taxes, the TEU and TFEU (the founding treaties) do not mention direct taxes. The only express reference to direct taxes was included in Art. 293 of the EC Treaty concerning the right of the Member States to conclude tax treaties in order to avoid double taxation. Such an express reference is no longer included in the TEU or the TFEU in the form as amended by the Lisbon Treaty. Both the TEU and the TFEU, however, apply to direct taxes despite the lack of an express reference.

**Case law**

No express provision exists concerning the interrelationship between EU law and the national laws of the Member States. Based on the judgments given by the Court of the European Union (the EU Court), however, it is clear that EU law takes precedence over national laws. The primacy of EU law applies both in relation to the founding treaties and the EU directives. Even though direct taxation falls under the purview of the Member States, the states must follow the EU law rules and principles when exercising this power.

EU law norms override national law provisions that are in conflict with EU law, regardless of the status or the age of the national law provision. EU law norms take precedence also in the case of a conflict between an EU law provision and a national constitutional provision. Because of the primacy of EU law, the Member States must not enact legislation or conclude tax treaties, nor apply existing legislation or tax
treaties in conflict with EU law. Domestic laws and tax treaties of the Member States must be applied and interpreted in accordance with EU law.

**Conflict must be abolished**

The domestic laws and tax treaties of the Member States may include provisions that are in conflict with EU law. Once the conflict has been discovered, these provisions must be amended or abolished in order to comply with EU law. For reasons of legal certainty, the conflicting provisions must be amended or abolished even though the tax authorities of the state concerned would not apply them in practice.

### 1.2.4 The principle of the most lenient provision

**Principal rule**

The main purpose of the EU tax law norms is to abolish tax obstacles within the internal market. Therefore, in relation to direct taxes, the precedence of EU law usually means that EU law takes precedence over the domestic law or tax treaty provisions when EU law leads to more lenient tax consequences for the taxpayer.

The domestic law or tax treaty norms on direct taxation that mean more lenient tax consequences to the taxpayer than EU law requires are seldom in conflict with EU law. EU tax law, for example, does not require a minimum corporate tax, i.e. that national corporate taxes exceed a certain level. Except for certain exceptions, the Member States have the right to choose not to levy certain direct taxes, provided that the tax treatment does not amount to state aid forbidden by the TFEU. Unlike in the case of direct taxes, the principle of the most lenient provision cannot be followed in the case of indirect taxes.

**Exception**

The transitional rules of the Savings Directive applying to Austria, Belgium and Luxemburg provide for an example of a situation in which the principle of the most lenient provision does not apply in the case of direct taxes. Because EU law takes precedence over conflicting tax treaties, the minimum source state withholding tax based on the transitional rules of the Savings Directive must be levied during the transitional period, even though there would be a tax treaty that does not allow any source state withholding tax to be levied.
For example, the tax treaties of Finland with Austria and Luxembourg do not give any source-state taxing rights to Austria or Luxembourg in regard to interest payments from these countries to Finnish resident individuals. For the first years of the transitional period, Austria and Luxembourg, however, must levy a 15% withholding tax on the interest payments that come under the scope of the Savings Directive. In the same way, according to the tax treaty concluded between Finland and Belgium, the source state interest withholding tax that may be levied is only 10%, but for the first years of the transitional period Belgium must levy a 15% withholding tax on the interest payments that come under the scope of the Savings Directive.

1.2.5 Direct effect and application

Relevance

EU law has direct effect and forms a part of the legal systems of the Member States without special national transformation acts. EU law creates directly rights and obligations to the organs of the Communities, to the Member States and to the citizens of the Member States. The EU tax law provisions that are sufficiently precise, clear and unconditional are directly applicable.

Both legal persons and individuals with the nationality of an EU Member State can rely on the directly applicable TEU and TFEU provisions and the directly applicable EU directive provisions before the tax authorities and the tax courts of the Member States, even if the provisions would have been implemented into domestic laws incorrectly or insufficiently. The tax authorities and the tax courts of the Member States must take the EU law provisions into account ex officio.

Taxation

The EU law provisions that are directly applicable and that are relevant in relation to direct taxes include, for example, the TFEU general non-discrimination rule (Art. 18; Art. 12 EC Treaty), the TFEU articles on the basic freedoms (Arts. 21, 45, 49, 56 and 63; Arts. 18, 39, 43, 49 and 56 EC Treaty) and the sufficiently precise provisions of the Parent-Subsidiary Directive, the Interest-Royalty Directive and the Merger Directive. Wherever the provisions of a directive are unconditional and sufficiently precise, those provisions may, in the absence of proper implementing measures adopted within the prescribed period, be relied upon.
**Vertical and horizontal direct effect**

Unlike horizontal direct effect, vertical direct effect is particularly relevant in relation to direct taxes. Vertical direct effect enables EU citizens to rely on the direct effect of the founding treaties and the EU directives in actions against the state. In relation to the founding treaties, however, horizontal direct effect, i.e. an individual's right to rely on such treaties in actions against another individual, is also possible.

In the case of directives, only vertical direct effect is possible. Horizontal direct effect is not possible because directives create obligations and are only enforceable against the state. Before a directive has been implemented into domestic law, the directive does not create obligations but only rights to individuals.

**1.3 Primary law**

**1.3.1 The founding treaties and the accession treaties**

**History**

The founding treaties of the European Communities, i.e. the European Coal and Steel Community (ECSC), the European (Economic) Community (EEC, later EC), and the European Atomic Energy Community (Euratom), form the basis of EU law. These treaties are in force in the form as amended by the Treaty on European Union – i.e. the Treaty of Maastricht (signed in 1992; entered into force in 1993), the Treaty of Amsterdam (signed in 1997; entered into force in 1999), the Treaty of Nice (signed in 2001; entered into force in 2003) and the Treaty of Lisbon (signed in 2007; entered into force in 2009). These treaties (i.e. the TEU and the TFEU) and the accession treaties of the new Member States are primary EU law.