Chapter 1 – The Sources of EU Law Relevant for Direct Taxation

Łukasz Adamczyk/Alicja Majdańska

I. General Overview
- A. Background
- B. Effects of EU Law
  1. Supremacy
  2. Direct Effect
     a) Direct Effect of the TFEU Treaty Provisions
     b) Direct Effect of the EU Directives' Provisions
  3. Direct Effect of the Provisions of EU International Agreements
  4. EU Institutions

II. Sources of EU Law
- A. Primary Law
  1. Fundamental Freedoms and State Aid
  2. Fundamental Rights
- B. Secondary Law
  1. Level of Harmonization
  2. Directives
  3. Regulations
- C. Soft Law
- D. EU International Agreements
  1. Agreements with third states or international bodies
  2. European Economic Area Agreement
  3. European Partnership Agreements (EPA)
  4. The Arbitration Convention

III. The Enforcement of EU Law
- A. European Union Level
- B. National Level (Preliminary Reference Procedure)
- C. Effectiveness of EU law
  1. Procedural Aspects of Redressing Breaches of EU Law
  2. Remedies against breaches of EU law

C. Soft Law

72 EU soft law comprises **non-binding recommendations and communications.** These are aimed at promoting Member States' voluntary compliance with EU law (see Chapter 2, m.no. 144 et seq.). As such, these tools play a steering function in tax coordination within the internal market since they promote a consistent interpretation and application of law and contribute to building an internationally accepted tax practice within the internal market.[117] For some time, given their lack of binding character, their relevance has been ignored by some Member States.

73 The EU is increasingly using soft law instruments for the purpose of enhanced coordination of the EU legal framework. In this context, the Recommendations on Tax Treaties and the Communication on External Strategy should be mentioned, which were issued as a part of the EU Anti Avoidance Package. These have supplemented the hard law instruments, i.e. Anti-Tax Avoidance Directive and Revised Administrative Cooperation Directive. The Communication on External Strategy has a particularly wide-ranging impact. Based on this document, the EU Council adopted an EU list of non-cooperative jurisdictions for tax purposes (so called EU tax haven blacklist), supplemented by monitoring and periodic screening of tax policies and also by defensive measures. Another initiative that is worth mentioning is the EU Joint Transfer Pricing Forum (JTPF), which assists and advises the European Commission on transfer pricing tax matters.[118] The JTPF has issued significant guidance and recommendations in this respect.

D. EU International Agreements

1. Agreements with third states or international bodies

74 Art. 217 TFEU (ex Art. 310 EC) clearly entitles the EU to conclude **agreements with third states or international bodies** (hereinafter: 'international agreements'). The EU competence covers both trade and investment agreements. It is, however, not exclusive. Non-direct investments and regimes governing dispute settlement between investors and States are excluded from its scope. As was explained in the CJEU's Opinion 2/15, these two fields falls within the shared competence of the EU and the Member States.[119] The issue of the dispute settlement between investors and States has been the subject of CJEU case law. In the *Achmea* case,[120] the Court made it clear that an arbitration clause in a bilateral investment treaty

---

117 Pistone, Soft Tax Law: Steering Legal Pluralism towards International Tax Coordination, in: Weber (ed.), *Traditional and Alternative Routes to European Tax Integration* (2010) p. 114.

118 For more *see* https://ec.europa.eu/taxation_customs/business/company-tax/transfer-pricing-eu-context/joint-transfer-pricing-forum_en.

119 CJEU, 16 May 2017, Opinion 2/15, *Free Trade Agreement Between the European Union and the Republic of Singapore*, EU:C:2017:376.

120 CJEU, 6 March 2018, Case C-284/16, *Slowakische Republik (Slovak Republic) v Achmea BV*, EU:C:2018:158.

III. The BEPS project and the new impetus for the coordination of tax policies in the EU

A. The role of the EU in global tax coordination and the BEPS project

159 In the aftermath of the 2008 financial crisis, the attention of governments and public opinion focused on the need to counter tax evasion, tax avoidance and aggressive tax planning strategies of large multinational enterprises, the scale of which has exponentially grown in recent decades.

160 The determination to fight this phenomenon culminated first in a global shift towards tax transparency and subsequently in the **OECD/G20 Base Erosion and Profit Shifting (BEPS) Project**, which is an unprecedented plan for achieving **international tax coordination at the global level** in order to constrain tax avoidance, agresssive tax planning and profit shifting techniques. In October 2015, the OECD published the results of its work on a 15-point Action Plan that contains detailed recommendations aimed at changing domestic laws and/or tax treaties in order to keep taxing rights aligned with value creation and effectively countering double non-taxation at the global level.[55]

161 The EU has recognized the dramatic impact of BEPS activities on tax revenues of the Member States and has put forward its own agenda in addition to endorsing general coordination with the OECD.

162 An initial programme to address tax avoidance and profit shifting at the EU level was set out in the Communication issued on 6 December 2012 – thus, even earlier than the first OECD Report on BEPS – which envisaged a whole range of measures, from enacting EU legislation to soft law coordination.[56] The next comprehensive package was issued in March 2015.[57] This package focused on transparency initiatives, translating international initiatives in part to the EU level and addressing EU specific issues. Next, the Commission released a Communication in June 2015 entitled "A Fair and Efficient Corporate Tax System in the European Union: 5 Key Areas for Action".[58] The objectives set out in the Communication, on the one hand, echoed the objectives of the BEPS project (i.e. aligning taxation and economic activity in the EU), emphasizing the need for a strong EU approach to corporate tax avoidance in the EU's external relations. On the other hand, the creation of a growth-friendly and competitive corporate tax environment in the EU was acknowledged as a priority of EU tax policy.

163 As the activity of the EU intensified on this matter, the dilemma became more and more apparent: **what role should the EU play in fighting tax avoidance and**

55 OECD, Base Erosion and Profit Shifting http://www.oecd.org/ctp/beps.htm [accessed 22 July 2020].
56 COM (2012) 722 final.
57 COM(2015) 136 final.
58 COM(2015) 302 final.

C. Justifications Not Accepted by the CJEU

1. Loss of Tax Revenue

282 The Court has **never accepted** the potential loss of tax revenue in cross-border situations as an overriding reason of public interest that can justify restrictive measures, in itself. The CJEU considers that when one Member State loses revenue, another State gains revenue (in an ideal world).[206] The answer is not that straightforward, however, once one takes a closer look at the principle of a balanced allocation of taxing rights. This principle provides that Member States are at liberty to apply restrictive national measures as long as these measures are aimed at ensuring that the economic activities performed in a State's territory are to be taxed in that State (see m.no. 264 et seq.). Thus, in fact, a State might defend itself against base erosion but only within the scope of that justification and subject to the conditions applicable to it (e.g. it must not have given up taxing powers over the same type of income domestically).

2. Difficulties in Obtaining Information

283 The 'difficulties in obtaining information' argument is the unfortunate twin brother of the 'effectiveness of fiscal supervision' justification. It delimits the boundaries beyond which the justification no longer works. As was already mentioned, the Court has been reluctant to accept that difficulties in obtaining information can act as a justification within the European Union for a simple reason – according to the Court there are no such difficulties due to the existence of the Mutual Assistance Directive (see Chapter 9). In principle, the Member States may obtain any information necessary regarding the collection of taxes by requesting that the taxpayer provide sufficient data that can be varified through the Directive – thus there is a presumption of effectiveness in exchanging information within the European Union.[207] Consequently, whenever a Member State has tried to justify a discriminatory provision on the basis that difficulties in obtaining information exist, the CJEU always denies the justification.[208] Furthermore, the Court has **never accepted practical difficulties** in obtaining information from certain Member States as a justification ground, pointing out that it is up to the Member States to make the instrument more effective.[209]

---

206 CJEU, 7 September 2004, Case C-319/02, *Manninen,* EU:C:2004:484; and CJEU, 10 April 2014, Case C-190/12, *Emerging Markets Series of DFA*, EU:C:2014:249, para. 103.

207 CJEU, 27 January 2009, Case C-318/07, *Persche*, EU:C:2009:33, paras. 51-72.

208 There is one theoretical possibility of relying on the need for effectiveness of fiscal supervision in the context of difficulties in obtaining information in intra-Community situations, which is, namely, Art. 17 of the Mutual Assistance Directive on the limits to the exchange of information obligation between the Member States. However, this has never been successfully invoked.

209 See CJEU, 9 October 2014, Case C-326/12, *Caster and Caster*, EU:C:2014:2269, para. 56; CJEU, 11 December 2014, Case C-678/11, *Commission v Spain*, EU:C:2014:2434, para. 61. This 'fundamentalist' approach to administrative cooperation was heavily criticized recently – see Ribeiro, Did the ECJ Go Too Far in *Brisal* (Case C-18/15)?, *ET* 2017, p. 500.

I. Background to the EU Prohibition of State Aid

296 The competition policy of the EU was developed to ensure **fair competition, proper functioning of markets and a competitive economy** within the internal market. Similar to competition rules applicable to cartels, abuse of dominance, forms of commercial cooperation and merger control, State aid control is part of the EU **rules on competition**. The State aid prohibition is laid down in **Art. 107(1) of the Treaty on the Functioning of the European Union (hereinafter TFEU)**,[2] which provides: "*Save as otherwise provided in the Treaties, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market.*" In short, it prohibits the provision of **advantages**, in any form, by national **public authorities** to **undertakings** on a **selective basis**. In particular, Art. 107(1) TFEU only applies to aid granted by Member States, which means that Union aid is not covered by the prohibition.[3] Nevertheless, the latter might have repercussions on the international arena, such as WTO law, where other prohibitions on subsidies exist.[4]

297 In general, prohibited State aid exists if **four cumulative conditions** are fulfilled:[5] First, the measure confers an advantage on its recipients that puts them in a more favourable position than other undertakings or relieves them of charges that are normally borne by undertakings. Second, the advantage is granted by the state or through State resources. Third, the advantage conferred is selective in that it favours "*certain undertakings or the production of certain goods*". Fourth, the measure affects competition and trade between Member States.

298 For more than two decades now, the Commission has been applying the prohibition against State aid under Art. 107(1) TFEU to tax matters. In addition to the State aid rules laid down under primary EU law, it has been using an array of "soft law" instruments, such as communications, notices and other non-binding instruments, to tackle harmful tax competition, promote good governance and combat corporate tax avoidance. In contrast to hard law, soft law is typically characterized by having no binding force.[6] One of the most relevant soft law instruments in the area of State aid provided by the Commission is the Notice on the notion of State aid as referred to in Art. 107(1) TFEU (hereinafter: Notion of aid notice).

---

2 Consolidated version of the Treaty on the Functioning of the European Union of 13 December 2007, OJ C 326 of 26 October 2012.

3 Englisch, Equality under State aid rules and VAT, *World Journal of VAT/GST Law* 8/2019, p. 22.

4 Hofmann, in: Hofmann/Micheau (eds.), *State aid law of the European Union* (2016) p. 36 et seq.

5 Commission Notice on the notion of State aid as referred to in Article 107 (1) of the Treaty on the Functioning of the European Union (hereinafter: Notion of aid notice), OJ C 262 of 19 July 2016, para. 5.

6 See Art. 288 TFEU.

IV. General Issues Raised by the Application of State Aid in Tax Matters

A. The Prohibition of State Aid and Direct Taxation. Harmonization of Direct Taxes through the Backdoor?

314 Since the Member States did not want to give up their sovereignty in direct tax matters when establishing and acceding to the EU, competence in respect of direct tax law, as opposed to indirect tax law, has remained, to a great extent, with the Member States. According to Art. 115 TFEU, a unanimous vote by the Member States is required to reach agreement to harmonize legislation concerning direct taxation. The persistent fruitless attempts to conclude the CCCTB, for example, show that it is very difficult to achieve consensus among the EU Member States. Nevertheless, the Member States need to respect EU principles and cannot use their tax sovereignty as an excuse to disregard the main rules, particularly the State aid prohibition.

315 The Commission has been increasingly focussing on identifying aid within individual corporate taxation. However, looking into each ruling and dictating how the Member States' tax authorities should apply national tax laws arguably constrains the tax sovereignty that Member States continue to want to retain. For this reason, the Commission has been heavily criticized for extending its competences conferred by the TFEU. With merit, it has been argued that direct tax law is secretly being harmonized through the application of competition law to individual direct taxation despite the reluctance of the Member States in this regard.

316 For the sake of completeness, it must be mentioned that, in fact, there is a legal competence under Art. 116 TFEU allowing the Council to adopt directives by way of a majority vote (instead of unanimity) in matters falling under the exclusive competence of the Member States to eliminate distortions of competition created by "*a difference between the provisions […] in Member States.*" If the distortive effect of disparities were to be considered serious enough, the Council could rely on this authorization. However, this legal basis has not been utilized in the tax law area to date.[51]

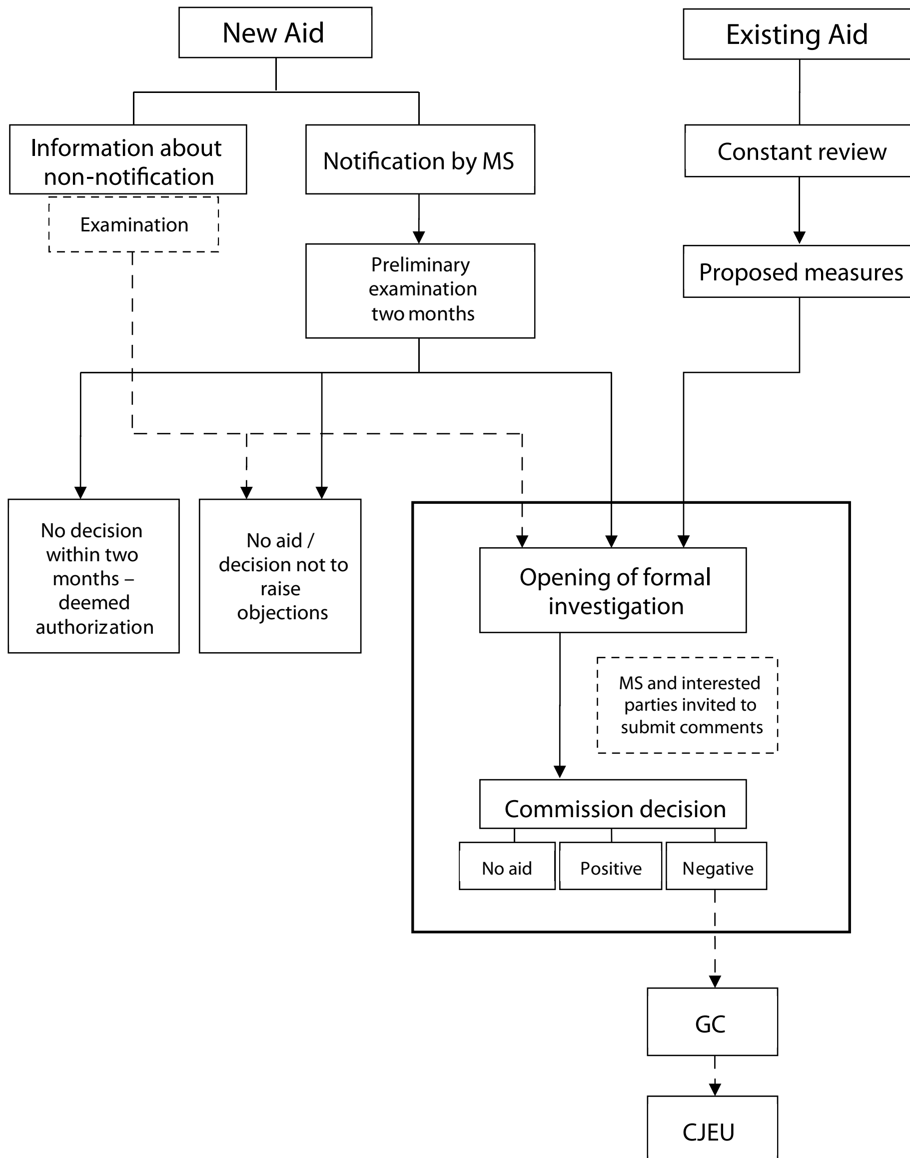
B. The Prohibition of State Aid and Indirect Taxation

317 For many years, the focus on fiscal State aid was mainly in the field of **direct business taxation**. However, the Commission has started to apply the principles laid down in the former Notice on business taxation in analyzing certain cases in the area of **indirect taxation** as well.[52]

51 Wattel, in: Richelle et al. (eds.), *State aid and business taxation* (2016) p. 70.

52 Report on the implementation of the Commission notice on the application of the State aid rules to measures relating to direct business taxation, COM(2004)434 of 9 February 2004, para. 71.

IX. Overview of the Procedural Treatment of State Aid



D. Definition of "Permanent Establishment"

427 The 2003 amending Directive included a definition of the term "**permanent establishment**", which was needed in the light of the broader scope of the Directive. The term "permanent establishment" is defined in Art. 2(b) as "*a fixed place of business situated in a Member State through which the business of a company of another Member State is wholly or partly carried on ….*"

428 The definition of Art. 2(b) refers to what is known as a **material permanent establishment**, defined in Art. 5(1) OECD MC. Moreover, such a definition requires the profits of a permanent establishment to be subject to tax in the Member State where the permanent establishment is located both under domestic and treaty law. The Directive does not envisage other types of permanent establishment provided for in Art. 5 OECD MC, such as the agency permanent establishment or construction permanent establishment dealt with in the OECD MC in Art. 5(3) and Art. 5(5), respectively. The definition contained in Art. 2(b) of the Directive should consider the treaty developments of EU Member States. For example, assume that EU Country A and EU Country B have both signed the OECD Multilateral Convention[25] and both have chosen Option A in Art. 13 of such Convention.[26] In such a case, if all the requirements are met for the application of the Directive, the broader treaty definition of permanent establishment resulting therefrom should also affect the definition of permanent establishment contained in Art. 2(b) of the Directive (with regard to intercompany dividend distributions involving the aforementioned countries). This conclusion relies on the fact that Art. 13 tackles the use of specific activity exemptions in order to artificially avoid the existence of a permanent establishmentand is thus aimed at countering a particular instance of abuse (i.e. fragmentation of the activities). Given that the Directive does not preclude the application of "agreement-based provisions required for the prevention of fraud or abuse" (see Art. 1(2) of the Directive), the broader definition of permanent establishment contained in the treaty between EU Country A and EU Country B should prevail over the definition of permanent establishment contained in Art. 2(b) of the Directive.

III. Objective and Territorial Scope

429 The analysis of the **objective scope** of the Directive will be divided into three main parts. The first part deals with the interpretation of the terms "distribution of profits" and "distributed profits". The second and third parts contribute to defining the objective and **territorial scope** of the Directive. In particular, the second part

25 *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (24 Nov. 2016).

26 Under Option A, the specific activity exemption is limited to circumstances in which the activity is of a "preparatory or auxiliary" nature, which requires a subjective analysis based on the concrete facts and circumstances of the case.

V. Procedural Provisions

A. Attestation of Fulfilment of Application Requirements

574 Art. 1(11) to (16) contains procedural provisions for the functioning of the Interest and Royalties Directive whereas Art. 1(11) to (14) regulates the **attestation procedure**.[77] Under the attestation procedure, the Interest and Royalties Directive differentiates between a simplified attestation procedure and an attestation procedure based on a decision. According to Art. 1(11), the simplified attestation procedure entails that the source Member State may require an attestation by which the fulfilment of the requirements laid down in Arts. 1 and 3 is established. The attestation must include the information listed in Art. 1(13) (proof of residence for tax purposes, proof of beneficial ownership of the receiving company, fulfilment of subject-to-tax requirement according to Art. 3(a)(iii), proof of minimum holding, proof of holding period).[78] In the attestation procedure, the source Member State has the right to make it a condition for the granting of the benefits of the Interest and Royalties Directive that its tax authority has issued a decision on source tax exemption based on the above-mentioned attestation. Thus, such a decision on source tax exemption is an optional additional requirement for the Member States when granting an attestation. It also should be mentioned that, according to Art. 1(14), if the requirements for exemption cease to be fulfilled, the receiving company or permanent establishment has an obligation to immediately inform the paying company or permanent establishment and, if the source Member State so requires, the competent authority of that source Member State. It has to be asked in this respect whether all the attestation requirements are still proportionate at a time in which the (European and worldwide) automatic exchange of information is making fast progress (see on that issue in detail Chapter 8). Probably, as the Interest and Royalties Directive itself will be amended sooner or later (see m.no. 546), it is likely that, in addition to the amendments discussed, Art. 5 of the Interest and Royalties Directive may also be changed.

B. Repayment of Tax Withheld at Source

575 If the source tax exemption requirements have not been attested to at the time of the interest or royalty payment, the source Member State may oblige the payer of the interest or royalty to withhold the tax at the time of the payment. As a consequence of a later attestation, the source Member State has to provide for a **reimbursement procedure,** the principles of which are laid down in Art. 1(15) and (16).[79]

77 Distaso/Russo, The EC Interest and Royalties Directive – A comment, *ET* 2004, p. 152 et seq.; Rodriguez, in: Thömmes/Fuks (eds.), *EC Corporate Tax Law* (October 2004) para. 252 et seq.

78 In the tax literature it is not exactly clear who should make the attestation; see on this issue Rodriguez, in: Thömmes/Fuks (eds.), *EC Corporate Tax Law* (October 2004) para. 263 et seq.

79 Distaso/Russo, The EC Interest and Royalties Directive – A comment, *ET* 2004, p. 153; Rodriguez, in: Thömmes/Fuks (eds.), *EC Corporate Tax Law* (October 2004) para. 265 et seq.

	Art. 25(5) OECD Model Convention	Arbitration Convention	Dispute Resolution Directive	MLI
Persons involved in the procedure	The two competent authorities	The two competent authorities. Under certain conditions limited involvement of taxpayer	The two competent authorities. Under certain conditions limited involvement affected person(s)	The two competent authorities
Composition of the decision making body	Each competent authority appoints an arbitrator; the two arbitrators appoint a third arbitrator who chairs the panel	Advisory commission composed of independent president, two authority representatives (this number may be reduced to one by agreement between the competent authorities) and two independent members	Advisory commission composed of one chair, one representative of each competent authority and one independent person of standing.[95] If an alternative dispute resolution committee (ADRC) is set up, such ADRC might have a different composition.	Each competent authority appoints an arbitrator; the two arbitrators appoint a third arbitrator who chairs the panel
Result	Panel may issue its own opinion or chose between the two settlements proposed by the competent authorities (dependent on respective DTC)	Advisory commission delivers opinion	Advisory commission or ADRC delivers opinion. If ADRC is set up possibility to opt for any alternative dispute resolution processes (e.g. last best offer arbitration process)	Panel may issue its own opinion or chose between the two settlements proposed by the competent authorities (dependent on the type of arbitration process)
Binding decision	Decision binding on the competent authorities (not binding if the competent authorities agree on a different resolution of all unresolved issues within six months)	Competent authorities may find alternative solution within six months; if ,they fail, they are bound by the opinion	Competent authorities may find alternative solution within six months of notification of the opinion of the advisory commission or ADRC; if they fail, they are bound by the opinion	Decision binding on the competent authorities (not binding if the competent authorities agree on a different resolution of all unresolved issues within three months)

95 If the competent authorities agree, the number of representatives of each country and/or independent persons of standing may be increased to two for each competent authority.