THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2022

MODULE 3.01 – EU DIRECT TAX OPTION

SUGGESTED SOLUTIONS

PART A

Question 1

The facts of the case are similar to the case C-28/17, NN.

The applicable freedom is the freedom of establishment, which Article 49 TFEU grants to European Union nationals and which includes, in accordance with Article 54 TFEU, for companies formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the European Union, the right to exercise their activity in other Member States through a subsidiary, branch or agency.

In order for the law of a Member State to constitute a barrier to the freedom of establishment of companies, it must result in a difference in treatment to the detriment of the companies exercising that freedom; that difference in treatment must relate to objectively comparable situations and must not be justified by an overriding reason in the public interest or proportionate to that objective (see *X Holding*, C-337/08).

According to the case-law of the Court, the comparability of a cross-border situation with an internal situation must be examined having regard to the objective pursued by the national provisions at issue (*X Holding*, C-337/08; *SCA Group Holding and Others*, C-39/13 to C-41/13; *Bechtel*, C-20/16; and *Bevola and Jens W. Trock*, C-650/16).

In the present case, it seems that the objective of the applicable domestic law provision is to prevent the double deduction of losses. The Court has held that, with regard to measures laid down by a Member State in order to prevent or mitigate the double taxation of a resident company's profits, companies which have a permanent establishment in another Member State are not, in principle, in a situation comparable to that of companies which have a resident permanent establishment (*Bevola and Jens W. Trock*, C-650/16).

By analogy, the Court held in case C-28/17, NN, para. 34 that the view must be taken, as regards the measures intended to prevent the double deduction of losses, that a group whose non-resident subsidiary has a resident establishment is also not in a situation comparable to that of a group whose subsidiary, and the latter's permanent establishment, are also resident.

At the same time the Court pointed out referring to its earlier judgment of *Bevola and Jens W. Trock*, C-650/16 that it is important to make an exception for the situation in which there is no other possibility of deducting the losses of the non-resident subsidiary attributable to the permanent establishment which is resident in the Member State in which the subsidiary is established. In that situation, the group whose subsidiary is situated in another Member State is not in a different situation to that of the purely national group, in the light of the objective of preventing the double deduction of its losses. The tax-paying capacity of the two groups is then affected in the same way by the losses of their resident permanent establishment.

Also, in that respect, the Court has already ruled that Member States must be able to prevent the risk of losses being taken into account twice (*Marks & Spencer*, C-446/03 and *Lidl Belgium*, C-414/06).

In a situation in which a permanent establishment's income is taxed by two Member States, it appears justified that the charges borne by that establishment should be capable of being deducted from that income in one and the other tax systems, in accordance with national rules. However, the existence of such a situation cannot simply be inferred from the fact that two Member States concurrently exercise their power of taxation over the profits of the same permanent establishment.

The tax agreements between Member States specifically designed to prevent double taxation cannot be disregarded. In that regard, and in light of the mechanism for the elimination of double taxation provided in the DTC the parallel exercise of the powers of taxation of two member states does not entail an obligation for the company in one member state which has a permanent establishment in another member state to pay income tax twice. In those circumstances, the taxpayer cannot claim a benefit to deduct the losses of such an establishment twice, that is to say, in both national tax systems.

In the absence of such a provision cross-border situations would confer an unjustified advantage over comparable national situations, in which a double deduction is not possible. The difference in treatment established by national legislation thus appears to be justified.

That difference in treatment must still be proportionate to its objective. It would go beyond what is necessary to prevent the double deduction of a loss in the case where the effect thereof would be to deprive a group of any possibility of deducting the loss of a resident subsidiary in a cross-border situation

Since the loss sustained by the permanent establishment in Azalia of ACo ‘s Brigorian subsidiary is, in principle, deductible from that subsidiary’s profits in Brigoria, which are taxable in Brigoria, it cannot be deducted from the taxable group profits in Azalia.

The loss is the result of the merger of two Azalian branches in the group and the choice made by the group — as permitted by Brigorian law — that that merger be treated for tax purposes as a restructuring of activities, and, as such, not subject to tax in Brigoria. Consequently, it would not be possible, in practice, to set those losses off against the Brigorian subsidiary’s profits. Therefore, not allowing the deduction of the losses in Azalia would not respect the principle of proportionality.

That principle would be respected if the setting off, against the Azalian group’s profits, of the loss sustained by the resident permanent establishment of its non-resident (Brigorian) subsidiary were accepted, by derogation from the domestic legislation, since the group would have demonstrated that the setting off of the abovementioned losses against the subsidiary’s profits is actually impossible in the other Member State.

To conclude: Article 49 TFEU must be interpreted as not precluding, in principle, national legislation, according to which the resident companies in a group are permitted to deduct, from their group profits, the losses sustained by a resident permanent establishment of a non-resident subsidiary of that group only in the case where the rules applicable in the Member State in which that subsidiary has its registered office do not permit those losses to be deducted from the latter’s profits, when the application of that legislation is combined with that of a convention preventing double taxation allowing, in the latter Member State, the deduction from the income tax payable by the subsidiary of a sum corresponding to the income tax paid, in the Member State on the territory of which that permanent establishment is situated, in respect of the latter’s activity.

However, Article 49 TFEU must be interpreted as precluding such legislation in the case where the effect of its application is to deprive that group of any effective possibility of deducting those losses from the group’s overall profits, where it is not possible to set off those losses against that subsidiary’s profits in the Member State on the territory of which that subsidiary is established.

Question 2

The facts are similar to the case C-405/18, AURES.

X Co, by the cross-border transfer of its place of effective management has exercised the freedom of establishment. The impossibility for it to deduct the 2017 tax loss in the Zubia which it can no longer claim in Xanthia amounts to an unjustified restriction on that freedom.

Article 49 TFEU, read in conjunction with Article 54 TFEU, extends the benefit of freedom of establishment to companies or firms formed in accordance with the legislation of a Member State and having their registered seat, their central administration or principal place of business within the European Union.

The Court has previously held that a company incorporated under the law of a Member State which transfers its place of effective management to another Member State, without that transfer affecting its status as a company of the former Member State, may rely on Article 49 TFEU for the purpose, inter alia, of challenging the tax consequences resulting from that transfer in the Member State of origin (*National Grid Indus*, C-371/10).

Similarly, such a company, in such circumstances, may therefore rely on Article 49 TFEU for the purposes of challenging its tax treatment in the Member State to which it has transferred its place of effective management. A cross-border transfer of that place of management therefore falls within the scope of that article.

Article 49 TFEU must be interpreted as meaning that a company incorporated under the law of a Member State, which transfers its place of effective management to another Member State without that transfer affecting its status as a company incorporated under the law of the first Member State, may rely on that article for the purposes of contesting a refusal in the second Member State to defer losses prior to that transfer (AURES §28).

Freedom of establishment, which Article 49 TFEU grants to EU nationals, includes, in accordance with Article 54 TFEU, for companies or firms formed in accordance with the law of a Member State and having their registered seat, central administration or principal place of business within the European Union, the right to exercise their activity in other Member States through a subsidiary, branch or agency. These provisions of EU law on freedom of establishment are, inter alia, aimed at ensuring that foreign nationals are treated in the host Member State in the same way as nationals of that State.

The Treaty offers no guarantee to a company covered by Article 54 TFEU that transferring its place of effective management from one Member State to another Member State will be neutral as regards taxation. Given the relevant disparities in the tax legislation of the Member States, such a transfer may be to the company's advantage in terms of tax or not, according to circumstances. Freedom of establishment cannot therefore be understood as meaning that a Member State is required to draw up its tax rules on the basis of those in another Member State in order to ensure, in all circumstances, taxation which removes any disparities arising from national tax rules (*National Grid Indus*, C-371/10).

In the present case, it should be noted that the possibility available under the law of a Member State to a resident company to claim a loss incurred in that Member State during a given tax year, so that that loss may be deducted from the taxable profits made by such a company in subsequent tax years, constitutes a tax advantage.

To exclude a loss incurred by a company resident in one Member State but incorporated in another Member State under the latter's law during the tax year in which that company was resident in the Member State of incorporation from the benefit of that advantage, whereas that advantage is granted to a company resident in the Member State of residence which incurred a loss in the same tax year, constitutes a difference in tax treatment.

By reason of that difference in treatment, a company incorporated under the law of a Member State might be dissuaded from transferring its place of effective management to another Member State in order to pursue its economic activities there.

Such a difference in treatment resulting from a Member State's tax legislation to the detriment of companies exercising their freedom of movement can be permissible only if it relates to cases which are not objectively comparable or if it is justified by an overriding reason in the public interest (*Nordea Bank Danmark*, C-48/13, and *Timac Agro Deutschland*, C-388/14).

According to the case-law of the Court, the comparability of a cross-border situation with an internal situation must be examined having regard to the aim pursued by the national provisions at issue (*Bevola and Jens W. Trock*, C-650/16).

By providing that a company may not claim, in the Member State in which it is now resident, a loss incurred in a tax year in which it was a tax resident of another Member State, the domestic legislation is conducive, in essence, to preservation of the allocation of the power to impose taxes between the Member States and to prevent the risk of double deduction of losses.

As regards a measure pursuing such objectives, it must be held that a company resident in a Member State which has incurred a loss in that Member State and a company which has transferred its place of effective management and, consequently, its tax residency to that Member State having incurred a loss during a tax year during which it was a tax resident of another Member State, without any activity in the former Member State are not, in principle, in a comparable situation.

The situation of a company which effects such a transfer is subject to the tax jurisdiction of two Member States, namely, first, the Member State of origin, in respect of the tax year during which the loss is incurred, and, second, the host Member State, in respect of the tax year for which that company applies for that loss to be deducted.

Accordingly, where the host Member State has no tax jurisdiction over the tax year during which the loss at issue arose, the situation of a company, which has transferred its tax residency to that Member State and subsequently claims a loss there previously incurred in another Member State, is not comparable to that of a company the turnover of which was subject to the tax powers of the previous Member State on the basis of the tax year during which that company incurred that loss (by analogy *Timac Agro Deutschland*, C-388/14).

Furthermore, the fact that a company which has transferred its tax residency from one Member State to another falls within the tax jurisdiction of two Member States is liable to give rise to a greater risk of that loss being taken into account twice, since such a company might claim the same loss in respect of the authorities of both Member States.

As regards losses attributable to a non-resident permanent establishment which has ceased activity and whose losses could not, and no longer can, be deducted from its taxable profits in the Member State in which it carried on its activity, the situation of a resident company possessing such an establishment is not different from that of a resident company possessing a resident permanent establishment, from the point of view of the objective of preventing double deduction of the losses, despite the fact that the situations of those two companies are not, in principle, comparable (*Bevola and Jens W. Trock*, C-650/16).

However, such an approach cannot be accepted in the case of a company which, after transferring its place of effective management and, as a result, its tax residency from the Member State of its registered seat to another Member State, seeks to deduct in that other Member State a loss incurred in the former Member State in respect of a tax year during which that company fell exclusively within the tax jurisdiction of that Member State.

The Member State to which a company transfers its place of effective management cannot be required to take into account a loss incurred before that transfer which relates to tax years in respect of which that company did not fall within the tax jurisdiction of that Member State.

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

In conclusion: Article 49 TFEU must be interpreted as not precluding legislation of a Member State which excludes the possibility for a company, which has transferred its place of effective management and, as a result, its tax residency to that Member State, from claiming a tax loss incurred, prior to that transfer, in another Member State, in which it has retained its registered seat (see C-405/18, AURES, at para. 54).

PART B

Question 3

The facts are similar to the case C-575/17, SOFINA.

First of all, it is settled case-law of the Court that the measures prohibited by Article 63(1) TFEU, as restrictions on the movement of capital, include those which are such as to discourage non-residents from making investments in a Member State or to discourage that Member State's residents from doing so in other States (*Santander Asset Management SGIIC and Others*, C-338/11 to C-347/11; *Miljoen and Others*, C-10/14, C-14/14 and C-17/14; *Pensioenfonds Metaal en Techniek*, C-252/14).

Specifically, the less favourable treatment by a Member State of dividends paid to non-resident companies, compared to the treatment of dividends paid to resident companies, is liable to deter companies established in a Member State other than that first Member State from undertaking investments in that same first Member State and, consequently, amounts to a restriction of the free movement of capital, prohibited, in principle, under Article 63 TFEU (*Pensioenfonds Metaal en Techniek*, C-252/14, paragraph 28 and the case-law cited).

Whereas the dividends paid to a non-resident company are subject to immediate and definitive taxation, the tax imposed on dividends paid to a resident company depends on whether the latter's financial year is net loss-making or net profit-making. Thus, where losses are made, the taxation of those dividends is not only deferred to a subsequent profit-making year, thus procuring a cash-flow advantage for the resident company, but is also thereby uncertain, since that tax will not be levied if the resident company ceases trading before becoming profitable.

The exclusion of a cash-flow advantage in a cross-border situation when it is granted in an equivalent situation on national territory constitutes a restriction on the free movement of capital (*Marks & Spencer*, C-446/03; *Commission* v *Spain*, C-269/09).

Secondly, the assessment of whether there exists a potentially less favourable treatment of the dividends paid to non-resident companies must be undertaken for each tax year, taken individually (*Pensioenfonds Metaal en Techniek*, C-252/14). Since the dividends received by a non-resident company are taxed at the time when they are distributed, the financial year in which the distribution of those dividends occurs must be taken into account in order to compare the tax burden on such dividends and that on dividends paid to a resident company. Such a difference in tax treatment of dividends dependent on the place of residence of the companies receiving those dividends is liable to deter (i) non-resident companies from investing in companies established in Corland, and (ii) investors residing in Corland from purchasing holdings in non-resident companies.

In so far as that provision is a derogation from the fundamental principle of the free movement of capital, it must be interpreted strictly. It cannot therefore be interpreted as meaning that all tax legislation which draws a distinction between taxpayers on the basis of their place of residence or of the Member State in which they invest their capital is automatically compatible with the Treaty. The derogation provided for in Article 65(1)(a) TFEU is itself restricted by Article 65(3) TFEU, which provides that the national provisions referred to in Article 65(1) 'shall not constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital and payments as defined in Article 63 [TFEU]' (*Miljoen and Others*, C-10/14, C-14/14 and C-17/14).

According to the settled case-law of the Court, as soon as a Member State, either unilaterally or by way of a convention, imposes a charge to tax on the income of both resident and non-resident taxpayers from dividends which they receive from a resident company, the situation of those non-resident taxpayers becomes comparable to that of resident taxpayers (*Commission* v *Germany*, C-284/09; *Miljoen and Others*, C-10/14, C-14/14 and C-17/14).

Since that legislation procures a substantial tax advantage for loss-making Corland companies which is not granted to loss-making companies established in Della, it cannot be claimed that the difference in treatment in the taxation of dividends that depends on whether those dividends are received by a resident or non-resident company is restricted to the arrangements for the collection of tax. It constitutes a difference in treatment that is not justified by an objective difference in situation.

Another possible justification to examine is the preservation of the balanced allocation of taxation powers between Member States. It constitutes a legitimate objective and, in the absence of any unifying or harmonising measures adopted by the European Union, the Member States retain the power to define, by treaty or unilaterally, the criteria for allocating their powers of taxation (*Brisal and KBC Finance Ireland*, C-18/15). Such a justification can be accepted where, inter alia, the rules at issue are intended to prevent behaviour capable of jeopardising the right of a Member State to exercise its powers of taxation in relation to activities carried on in its territory (*Commission* v *Spain*, C-269/09).

In the present case Corland has chosen to tax the dividends paid to a non-resident company (in Della) by means of a withholding tax at a rate fixed in a double taxation agreement, while not taxing dividends paid to a resident company that is loss-making. The deferral of the taxation of dividends received by a loss-making non-resident company would not mean that Corland has to waive its right to tax income generated on its territory. The dividends distributed by the resident company would, in fact, be subject to taxation once the non-resident company became profitable during a subsequent tax year, in the same way as is the case for a resident company in a similar situation.

If the non-resident company were to fail to become profitable prior to ceasing trading, this would result in an effective exemption of the income generated by the dividends and give rise to tax losses for the Member State of taxation.

However, a reduction in tax revenue cannot be regarded as an overriding reason in the public interest which may be relied on to justify a measure which is, in principle, contrary to a fundamental freedom (*Commission* v *Germany*, C-284/09). Accordingly, Corland cannot claim that the loss of tax revenue associated with the taxation of dividends received by non-resident companies in the event of their ceasing trading is of such a nature as to justify a withholding tax on that income so far as concerns solely those companies, when Corland consents to such losses when resident companies cease trading without returning to profitability.

Therefore, the justification based on the preservation of the balanced allocation of powers of taxation between the Member States cannot be accepted.

The need to ensure the effective collection of tax is a legitimate objective capable of justifying a restriction on fundamental freedoms, provided, however, that that restriction is applied in such a way as to ensure achievement of the aim pursued and not go beyond what is necessary for that purpose (*Brisal and KBC Finance Ireland*, C-18/15). Retention at source is a legitimate and appropriate means of ensuring the tax treatment of the income of a person established outside the State of taxation (*X*, C-498/10). But this justification cannot be accepted, as inter alia, Council Directive 2010/24/EU of 16 March 2010 allows the Member State in which dividends are paid to obtain, from the Member State of residence, the information necessary to allow it to recover a tax liability which arose when the dividends were distributed.

To conclude: Articles 63 and 65 TFEU preclude the legislation of Corland pursuant to which the dividends paid by a resident company are subject to a withholding tax when they are received by DCo, a company resident in Della, whereas, when such dividends are received by a resident Corland company, under the general corporation tax rules they are subject to taxation at the end of the financial year in which they were received only if the latter company was profitable in that financial year, and such taxation may, where applicable, never be levied if that company ceases trading without becoming profitable after receiving those dividends.

Question 4

The facts of the case are similar to the set of facts of the case C-53/19 P*, Banco Santander* and C-51/19 P World Duty Free Group concerning the debate on the selectivity of Spanish amortisation of financial goodwill rules.

As a preliminary point, it should be noted that, according to the Court's settled case-law, classification of a national measure as 'State aid', within the meaning of Article 107(1) TFEU, requires all the following conditions to be fulfilled. First, there must be an intervention by the State or through State resources. Secondly, the intervention must be liable to affect trade between the Member States. Thirdly, it must confer a selective advantage on the recipient. Fourthly, it must distort or threaten to distort competition. National measures that confer a tax advantage which, although not involving a transfer of State resources, place the recipients in a more favourable financial position than other taxpayers are capable of procuring a selective advantage for the recipients and, consequently, of constituting State aid, within the meaning of Article 107(1) TFEU.

Concerning the condition relating to the selectivity of the advantage, it follows from the settled case-law of the Court that it requires a determination as to whether, under a particular legal regime, the national measure at issue is such as to favour 'certain undertakings or the production of certain goods' over other undertakings which, in light of the objective pursued by that regime, are in a comparable factual and legal situation and which accordingly suffer different treatment that can, in essence, be classified as discriminatory (*Commission* v *Poland*, C-562/19 P).

The examination of whether such a measure is selective is thus, in essence, coextensive with the examination of whether it applies to a set of economic operators in a non-discriminatory manner (*Commission* v *Hansestadt Lübeck*, C-524/14 P).

Where the measure at issue is conceived as an aid scheme and not as individual aid, it is for the Commission to establish that that measure, although it confers an advantage of general application, confers the benefit of that advantage exclusively on certain undertakings or certain sectors of activity. In order to classify a national tax measure as 'selective', first we must identify the reference system, that is the 'normal' tax system applicable in the Member State concerned. At a second stage the Commission must demonstrate that the tax measure at issue is a derogation from that reference system, in so far as it differentiates between operators who, in the light of the objective pursued by that system, are in a comparable factual and legal situation.

The concept of 'State aid' does not cover measures that differentiate between undertakings which, in the light of the objective pursued by the legal regime concerned, are in a comparable factual and legal situation, and are, therefore, a priori selective, where the Member State concerned is able to demonstrate that that differentiation is justified, in the sense that it flows from the nature or general structure of the system of which those measures form part.

The determination of the reference framework is of particular importance in the case of tax measures, since the existence of an economic advantage for the purposes of Article 107(1) TFEU may be established only when compared with 'normal' taxation. Thus, determination of the set of undertakings which are in a comparable factual and legal situation depends on the prior definition of the legal regime in the light of whose objective it is necessary, where applicable, to examine whether the factual and legal situation of the undertakings favoured by the measure in question is comparable with that of those which are not.

Where the tax measure in question is inseparable from the general tax system of the Member State concerned, reference must be made to that system. On the other hand, where it appears that such a measure is clearly severable from that general system, it cannot be ruled out that the reference framework to be taken into account may be more limited than that general system, or even that it may equate to the measure itself, where the latter appears as a rule having its own legal logic and it is not possible to identify a consistent body of rules external to that measure.

Since outside the spheres in which EU tax law has been harmonised, it is the Member State concerned which defines, by exercising its exclusive competence in the matter of direct taxation, the characteristics constituting the tax, the determination of the reference system or the 'normal' tax regime, from which it is necessary to analyse the condition relating to selectivity, must take account of those characteristics (see, to that effect, judgment of 16 March 2021, *Commission* v *Poland*, C-562/19 P, EU:C:2021:201, paragraphs 38 and 39). The Court has held on numerous occasions that the objective pursued by measures of State intervention is not sufficient to exclude those measures outright from classification as ‘aid’ for the purposes of Article 107 TFEU, since that provision does not distinguish between measures of State intervention by reference to their causes or their aims but defines them in relation to their effects.

A finding that the measure is selective is not necessarily the result of it being impossible for certain undertakings to benefit from the advantage provided for by the measure at issue on account of legal, economic or practical restrictions which prevent the performance of the transaction governing whether that advantage is granted, but may arise merely from the finding that a transaction exists which, although it is comparable to the transaction which governs whether the advantage in question is granted, does not give rise to the right to that advantage. Accordingly, a tax measure may be selective even though any undertaking may freely choose whether to perform the transaction which governs whether the advantage provided for by that measure is granted.

The measure at issue gives undertakings taxable in Marina which have chosen to acquire shareholdings in non-resident companies an advantage over undertakings taxable in Marina which have chosen to acquire shareholdings in resident companies. When they perform a transaction to acquire a shareholding in a resident company, undertakings taxable in Marina cannot, in respect of that transaction, obtain the advantage provided for by the measure at issue.

Thus, where an undertaking taxable in Marina has chosen to acquire shareholdings in a non-resident company, it is therefore — within the framework of that transaction — treated more favourably than any other undertaking, including itself which chooses to acquire shareholdings in a resident company. It follows that a national tax measure such as the measure at issue, which grants an advantage upon satisfaction of the condition that an economic transaction is performed, may be selective including where, having regard to the characteristics of the transaction concerned, any undertaking may freely choose whether to perform that transaction.

In light of the above the measure although it was a measure of general application, in fact it is considered selective, as it constituted a derogation from the normal tax system that benefited only undertakings that chose to invest in non-resident companies.

PART C

Question 5

The EU has taken important steps forward in recent years, for instance, by adopting and starting to implement the Anti-tax Avoidance Directives (ATAD) and the Directive on Administrative Cooperation (DAC). Under the Code of Conduct Group on Business Taxation, Member States continue to peer review each others' tax regimes to ensure that they comply with the principles of fair tax competition.

In addition, the European Parliament has been very active in the area of taxation in general, and business taxation in particular. Moreover, in July 2020 the Commission adopted an ambitious Action Plan to make taxation fairer, simpler and more adapted to modern technologies and the Communication on Tax Good Governance in the EU and beyond, which aims to further strengthen the EU's promotion of transparency and fair taxation both at European and global level. This Communication set out further measures in the area of business taxation in both the short and longer term.

Regarding the OECD work on Pillar 1 and Pillar 2, it is expected that once agreed and translated into a multilateral convention, the application of Pillar 1 will be mandatory for participating countries. In order to ensure its consistent implementation in all EU Member States, including those that are not Members of the OECD and do not participate in the Inclusive Framework, the Commission will propose a Directive for the implementation of Pillar 1 in the EU.

In order to ensure its consistent application within the EU and compatibility with EU law, the principal method for implementing Pillar 2 will be an EU Directive that will reflect the OECD Model Rules with the necessary adjustments. The implementation of a global agreement on minimum effective taxation will also have implications for existing and pending EU Directives and initiatives. The EU's business tax agenda for the next two years goes beyond the work of the OECD.

A first step for a fairer tax system is a greater public transparency on the taxes paid by large economic actors. In addition the EU steps up the fight against the abusive use of shell companies – i.e. companies with no or minimal substantial presence and real economic activity – through a new legislative initiative to neutralise the misuse of shell entities for tax purposes.

While several actions at EU and international level provide instruments to tackle the use of abusive tax structures, legal entities with no or only minimal substance and economic activity continue to pose a risk of being used for improper purposes, such as aggressive tax planning, tax evasion or money laundering. While there can be valid reasons for the use of such entities, there is a need for further action to tackle entities and structures created for the main purpose of reducing the tax liability or disguising improper conduct of the group or operations they belong to, without substance and real economic activities in the countries where they are incorporated.

The Commission proposal would encompass actions such as requiring companies to report to the tax administration the necessary information to assess whether they have substantial presence and real economic activity, denying tax benefits linked to the existence or the use of abusive shell companies, and creating new tax information, monitoring and tax transparency requirements. The Commission also intends to take further steps to prevent royalty and interest payments leaving the EU from escaping taxation (so-called 'double non-taxation').

In parallel, the Commission will continue to use all tools at its disposal to ensure companies pay their fair share of tax, including the enforcement of State aid rules. While direct taxation falls within the competence of Member States, Member States must exercise that competence consistently with Union law, including State aid rules.

Question 6

The concept of mutual trust in the area of assistance in the collection of taxes is explained by the Court in its judgment in the case C-420/19, Heavyinstall of 20 January 2021.

The term “mutual trust” is not mentioned in the Treaties, however it has been assigned the status of a principle and is considered an essential building block of the Union legal system.

The principle of mutual trust applies also in the area of mutual assistance in the collection of taxes.

In *Donnellan*, C-34/17, at paragraph 40, the Court confirms that both the principle of mutual trust between the Member States and the principle of mutual recognition, which is based on the first of those principles, are of fundamental importance in EU law, given that they allow an area without internal borders to be created and maintained. This was not the first time that the Court referred to the principle of mutual trust. In Opinion 2/13 on the Accession of the EU to the European Convention on Human Rights (ECHR), the Court of Justice emphasized that “the principle of mutual trust between the Member States is of fundamental importance in EU law, given that it allows an area without internal borders to be created and maintained”. This has been recognized by the Court already since earlier years, for example in 2011 in the NS judgment where the Court held that “the raison d’être of the European Union and the creation of an area of freedom, security and justice [...] [are] based on mutual confidence and a presumption of compliance, by other Member States, with European Union law and, in particular, fundamental rights” (joined cases C-411/10 and C-493/10, NS).

As the Court points out in C-420/19, Heavyinstall, para. 40, so far as concerns the teleological interpretation of Directive 2010/24, it should be borne in mind that that directive, while falling within the area of the internal market and not that of the area of freedom, security and justice, is based on the principle of mutual trust. The implementation of the system of mutual assistance established by Directive 2010/24 depends on the existence of such trust between the national authorities concerned (see also *Donnellan*, C-34/17, paragraph 41).

Recital 1 of the directive provides that “Mutual assistance between the Member States for the recovery of each others’ claims and those of the Union with respect to certain taxes and other measures contributes to the proper functioning of the internal market. It ensures fiscal neutrality and has allowed Member States to remove discriminatory protective measures in cross-border transactions designed to prevent fraud and budgetary losses.”

Recital 4 provides that “To better safeguard the financial interests of the Member States and the neutrality of the internal market, it is necessary to extend the scope of mutual assistance for recovery to claims relating to taxes and duties not yet covered by mutual assistance for recovery, whilst in order to cope with the increase in assistance requests and to deliver better results, it is necessary to make assistance more efficient and effective and to facilitate it in practice.”

Recital 6 of the directive provides that “This Directive should not affect the Member States’ competence to determine the recovery measures available under their internal legislation. However, it is necessary to ensure that neither disparities between national laws nor lack of coordination between competent authorities jeopardise the seamless operation of the mutual assistance system provided for in this Directive.”

Article 16 of the directive provides that at the request of the applicant authority, the requested authority shall take precautionary measures, if allowed by its national law and in accordance with its administrative practices, and subject to the other conditions set in the said article. The document drawn up for permitting precautionary measures in the applicant Member State and relating to the claim for which mutual assistance is requested, if any, shall be attached to the request for precautionary measures in the requested Member State. This document shall not be subject to any act of recognition, supplementing or replacement in the requested Member State.

An interpretation of Article 16 of Directive 2010/24 that would allow the courts of the requested Member State to carry out a fresh examination of the conditions of application of precautionary measures, in the light of their national law, however, in particular where the assessment of those conditions is contained in the document provided for in the second subparagraph of Article 16(1) of that directive, would be contrary to the principle of mutual trust – on which that directive is based – and to the requirements relating to the seamless operation and the effectiveness of the system of mutual assistance established by that directive.

It follows, therefore, from a literal interpretation of Article 16 of Directive 2010/24 as well as from the context of that provision and from the objectives pursued by that directive that the courts of the requested Member State are, in principle, bound by the assessment made by the authorities of the applicant Member State of compliance with the conditions of application of precautionary measures, in particular where that assessment is contained in the document provided for in the second subparagraph of Article 16(1) of Directive 2010/24, attached to the request for assistance.

In conclusion, according to the Court in case C-420/19, *Heavyinstall,* Article 16 of Directive 2010/24 under the light of the principle of mutual trust must be interpreted as meaning that the courts of the requested Member State, ruling on a request for precautionary measures, are bound by the assessment of the factual and legal compliance with the conditions laid down for the application of those measures made by the authorities of the applicant Member State, in particular where that assessment is contained in the document referred to in the second subparagraph of Article 16(1) of that directive, attached to that request.

Question 7

There are multiple dispute resolution mechanisms available for cross-border tax disputes in the EU.

First of all Article 25 of the Double tax Conventions provides for the mutual agreement procedure. In some cases, especially for the treaties that have been amended by the MLI and where both member states have opted for mandatory binding arbitration, the mutual agreement procedure is complemented by arbitration making the whole procedure more effective.

Students may also refer to the fact that the Court of Justice of the European Union is also designated as an arbitration court in the DTC between Germany and Austria.

A special instrument that is available to EU member states is the so-called Arbitration Convention (Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises 90/463/EEC). The convention is not part of EU law. It is a multilateral international law instrument. As such, the CJEU does not have competence on the application and interpretation of the Arbitration Convention.

The EU Arbitration Convention establishes a procedure to resolve disputes where double taxation occurs between enterprises of different Member States as a result of an upward adjustment of profits of an enterprise of one Member State. Whilst most bilateral double taxation treaties include a provision for a corresponding downward adjustment of profits of the associated enterprise concerned, they do not generally impose a binding obligation on the Contracting States to eliminate the double taxation.

The Convention provides for the elimination of double taxation by agreement between the contracting states including, if necessary, by reference to the opinion of an independent advisory body. The Convention thus improves the conditions for cross-border activities in the Internal Market. The Arbitration Convention however applies only for the resolution of transfer pricing disputes and therefore it has a limited scope.

The EU Dispute Resolution directive adopted in 2017 has a broader scope as it applies for any dispute that may arise in connection with the application or interpretation of a double taxation convention that is concluded between member states.

The EU Dispute Resolution directive (Directive 2017/1852 of 10 October 2017) established a new framework that applies since 1 July 2019. They new rules bring a significant improvement to resolving tax disputes, as they ensure that businesses and citizens can resolve disputes related to the interpretation and application of tax treaties more swiftly and effectively.

The new rules also cover issues related to double taxation which occurs when two or more countries claim the right to tax the same income or profits of a company or person. This can happen, for example, due to a mismatch in national rules or different interpretations of the transfer pricing rules in a bilateral tax treaty.

Mutual agreement procedure (MAP) is an administrative procedure between the competent authorities of Member States engaged in a tax dispute. During the MAP, the competent authorities endeavour to resolve the dispute. The timelimit of the Directive for a MAP is 2 years, or 3 years if this is extended on a justified request by a competent authority.

In case the dispute is not resolved with a MAP between competent authorities, the taxpayer can request to set up an Advisory Commission. The Advisory Commission is composed of the competent authorities of the Member States in dispute and three independent persons (one of whom acts as the Chair). These persons are drawn from a purpose-compiled list to which they get nominated by Member States in accordance with the Directive.

The competent authorities sitting in the Advisory Commission have to agree on Rules of Functioning that provide for details on the procedure. In case the Rules of Functioning are not notified to the taxpayer or are notified incomplete, the members shall use the standard Rules of Functioning.

Once set-up, the Advisory Commission has to deliver its opinion within 6 months.

After the Advisory Commission delivers its opinion, the opinion is notified to the competent authorities. On the basis of this opinion, the competent authorities of the Member States concerned make a final decision. If they do not manage to agree a final decision on time, the opinion becomes binding on the competent authorities. Details of the decisions will be published online.

It is provided that the Directive will supersede any other dispute resolution mechanism that the taxpayer may have initiated for the resolution of the same issue. Once the taxpayer chooses to employ the mechanism of the Directive, any other procedure that may have been opened previously, will immediately cease. This provision makes the mechanism of the Dispute Resolution Directive the preferred procedure for double tax treaty disputes between Eu member states.

Last but not least, as far as the effectiveness of the procedure is concerned it can be argued that taxpayers now enjoy enhanced legal certainty when it comes to seeking a solution to their cross-border tax disputes. In particular, a wider range of cases is covered and Member States have to comply with clear deadlines in order to agree on a binding solution, giving citizens and companies more timely decisions.

Question 8

The aim of the EU list of non-cooperative jurisdictions, which is published as an annex to conclusions adopted by the Ecofin Council, is not to name and shame countries, but to encourage positive change in their tax legislation and practices, through cooperation.

In November 2016, the Council mandated the Code of Conduct group (business taxation), a special group established by the Council, to carry out the preparatory work to establish the list.

The Code of Conduct group started with the screening of 92 jurisdictions, selected on the basis of:

- their economic ties with the EU;
- their institutional stability; and
- the importance of the country's financial sector.

The group's screening and assessment report was submitted to the Council, and on the basis of the report the first EU list was adopted on 5 December 2017. The list (Annex I to the Council conclusions) included 17 non-EU countries or territories. These jurisdictions had not made sufficient commitments in response to the EU's concerns. Accompanying the list was a state of play document (Annex II) setting out which jurisdictions had responded with sufficient commitments. These jurisdictions were expected to take effective action by the end of 2018, or in some cases 2019, to avoid being listed in the future.

Since the establishment of the first EU list in 2017, it was regularly updated in the following years and revised as a result of dynamic monitoring of the measures implemented by jurisdictions to comply with their commitments. This is a continuous process, which includes:

- updating criteria in line with international tax standards;
- screening countries against these criteria;
- engaging with countries that do not comply;
- listing and de-listing countries as they undertake (or not) reforms; and
- monitoring developments to ensure that jurisdictions do not backtrack on previous reforms.

This procedure is part of the EU's work to promote and strengthen tax good governance mechanisms, fair taxation, and global tax transparency in order to tackle tax fraud, evasion and avoidance. In addition, given the global nature of unfair tax competition, this also means addressing external challenges to EU countries' tax bases.

Jurisdictions that do not yet comply with all international tax standards but have committed to implementing reforms are included in a state of play document. Once a jurisdiction meets all its commitments, its name is removed from the list.

Jurisdictions are screened on a number of criteria in order to be considered cooperative for tax purposes. The EU listing criteria are as follows.

First, criteria relating to tax transparency:

- Jurisdictions should exchange tax data with all EU member states through automatic exchange of tax information (AEOI), either through the common reporting system (CRS) established by the OECD or through equivalent arrangements;

- Jurisdictions should also be able to exchange tax information on request (EOIR);

- Jurisdictions should be party to the OECD Multilateral Convention on Mutual Administrative Assistance in Tax Matters, or have a network of exchange arrangements in place that covers all EU member states; and

- The aspect of beneficial ownership will be incorporated at a later stage.

Second, criteria on the existence of fair taxation:

- Jurisdictions should not have harmful preferential tax measures; and

- Jurisdictions should not facilitate offshore structures or arrangements seeking to attract profits without any real economic activity

Third, criteria relating to the implementation of anti-BEPS measures:

- Jurisdictions should commit to implementing the OECD anti-BEPS minimum standards, which concern harmful tax measures, treaty shopping, country-by-country reporting and dispute resolution; and

- Jurisdictions should receive positive peer-review assessments for the effective implementation of the anti-BEPS minimum standard on country-by-country reporting.

<u>Improving good tax governance</u>

For the effectiveness of the EU list, it is important that EU member states put in place efficient defensive measures in non-tax and tax areas. Defensive measures help to protect their tax revenues, and fight against tax fraud, evasion and abuse.

Regarding non-tax areas, the Council invited EU institutions and member states to take the EU list into account in:

- foreign policy;
- development cooperation; and
- economic relations with third countries.

Furthermore, certain EU funding rules now explicitly refer to the list. Funds from several EU instruments cannot be channelled through entities in listed countries, including the:

- European Fund for Sustainable Development (EFSD);
- European Fund for Strategic Investments (EFSI);
- External Lending Mandate (ELM); and
- General framework for securitization.

In its conclusions of 12 March 2019, the Council welcomed the fact that the list "is being taken into account by the European Commission in the implementation of EU financing and investment operations".

EU member states have broad discretion on the type and scope of defensive measures they apply in the tax area. These largely depend on their national tax systems. Nevertheless, there is a certain degree of coordination.

EU countries agreed in December 2017 to apply at least one of the following administrative measures:

- reinforced monitoring of transactions;
- increased risk audits for taxpayers who benefit from listed regimes; and
- increased risk audits for taxpayers who use tax schemes involving listed regimes.

On 5 December 2019, the Council endorsed guidance for further coordination. Member states also committed, as of 1 January 2021, to use the EU list in the application of at least one of four specific legislative measures:

- non-deductibility of costs incurred in a listed jurisdiction;

- controlled foreign company (CFC) rules, to limit artificial deferral of tax to offshore, low-taxed entities;

- withholding tax measures (WHT), to tackle improper exemptions or refunds; and
- limitation of the participation exemption on shareholder dividends.

As a result of the above, member states apply or have taken steps to apply at least one of the four defensive measures agreed upon in the 2019 Guidance, whereas several states apply at least two of the four measures. Most EU member states also operate defensive measures of both administrative and legislative nature to jurisdictions mentioned in the EU list.

Last but not least, recent EU legislation also explicitly refers to the list. For example, EU transparency rules for tax intermediaries that were adopted in DAC 6 (Directive 2018/822/EU, amending directive 2011/16/EU) introduced new reporting requirements for tax schemes involving listed countries.