EU Corporate Tax Harmonisation

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A thesis submitted for the Degree of Master of Jurisprudence
Durham Law School
Durham University
Word Count: 45, 876 (excluding bibliography and front matter)

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2021

Abstract

Several problems arise from each Member State having their own corporate tax system and they have received increased publicity due to LuxLeaks and other scandals increasing the awareness of these problems. However, not all Member States want to change the status quo. The purpose of this thesis is therefore to establish what progress in the short and long term should look like in respect of tackling the problems which arise from the coexistence of 27 different corporate tax systems. To achieve this, the problems which arise due to the lack of harmonisation are identified and used as a framework for subsequent analysis of the different forms of harmonisation. Both the four freedoms case law and the State aid controls are analysed respectively. These two forms of negative harmonisation are assessed because positive harmonisation or integration would only be necessary if it would prove more effective at tackling the problems.

Positive harmonisation is assessed to ascertain whether it would provide a better response than negative harmonisation. This thesis demonstrates that the more effective a measure is likely to be, the less likely it is that a measure will gain the necessary support to be implemented. The unanimity requirement means that the Member States who benefit from the current differences between corporate tax systems by competing for FDI can veto corporate tax proposals that may be beneficial for the majority of Member States. As such, while in theory, positive harmonisation would provide the best solution, the most effective positive harmonisation measures are unlikely to be implemented. This thesis, therefore, illustrates that future progress at tackling the problems identified in Chapter One will only take place through negative harmonisation.

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Abbreviations

Acta Univ Agric et Silvic Mendelianae Brun: Acta Universitatis Agriculturae et Silviculturae Mendelianae Brunensis

Antitrust Bull: The Antitrust Bulletin

ATAD: The Anti-Tax Avoidance Directive

Can Tax J: Canadian Tax Journal

Chi J Int'l L: The Chicago Journal of International Law

CYELS: Cambridge Yearbook of European Legal Studies

EBOR: The European Business Organization Law Review

ECECSR: Economic Computation and Economic Cybernetics Studies and Research

EEPS: East European Politics and Societies: and Cultures

EIPR: European Intellectual Property Review

EStAL: European State Aid Law Quarterly

EuConst: The European Constitutional Law Review

Fla Tax Rev: The Florida Tax Review

Fordham Int'l LJ: Fordham International Law Journal

Hous Bus & Tax LJ: The Houston Business and Tax Law Journal

ICCLR: International Company and Commercial Law Review

Int ILR: The International Labour Review

Int J Econ Bus: International Journal of the Economics of Business

Int JLM: International Journal of Law and Management

Int Polit: International Politics

Int TLR: International Trade Law & Regulation

ITR: International Tax Review

J Austl Tax'n: Journal of Australian taxation.

JBL: Journal of Business Law

JCMS: JCMS: Journal of Common Market Studies -

JECL & Pract: Journal of European Competition Law and Practice

JIAAT: Journal of International Accounting, Auditing and Taxation

JIBLR: Journal of International Banking Law & Regulation

JIPLP: Journal of Intellectual Property Law & Practice

PCB: Private Client Business

Sw J Int'l L: Southwestern Journal of International Law

Wis Int'l LJ: Wisconsin International Law Journal

Acknowledgements

I would like to thank my primary supervisor, Professor Robert Schütze and my secondary supervisor, Professor Pierre Schammo for their help, guidance and feedback throughout my masters which has greatly enhanced this thesis. I would also like to thank Dr Anca Daniela Chirita and Dr Barend van Leeuwen for their insight and feedback during the review process.

Introduction

Since the EU's beginning in 1957 (then, the European Economic Community), there has been ever-increasing harmonisation of legal standards across a variety of sectors and areas. Harmonisation has primarily been focused on economic areas such as the European Single Market in 1993, the development of the Euro and the integration of indirect value-added tax.[1] However, not all areas have harmonised at the same pace. Direct taxation has always been an outlier, with attempts to harmonise or integrate being met with opposition from some Member states and certain legal and economic experts in this field.[2] This has meant that Member States remain free to set their own corporate tax rates.[3] Public awareness of corporate tax has increased despite the relative lack of harmonisation in the area of tax regulation, through the increased publicity caused by events such as LuxLeaks.[4] A higher level of awareness concerning the problems and issues which allow MNEs to lower their tax burdens has meant that this is a highly contentious issue. The legal position of direct corporate taxation in the EU remains the same notwithstanding this ever-increasing controversy. For the situation to change, unanimous support from all Member States would be needed.[5] This unanimity requirement reflects the politically sensitive nature of corporate tax harmonisation. The deadlock between those Member States who oppose and those who support increased harmonisation is therefore set to continue in the immediate future.

This thesis focuses on EU corporate tax harmonisation instead of worldwide corporate tax harmonisation since the world economies are substantially more diverse than EU economies. For these reasons, while President Biden's minimum corporate tax rate has gained support,

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[1] Single Market, <https://eur-lex.europa.eu/summary/chapter/internal_market.html?root_default=SUM_1_CODED%3D24&locale=en> accessed 16 August 2021; Euro, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=legissum%3A140202_1> accessed 16 August 2021; VAT,<https://commonslibrary.parliament.uk/research-briefings/sn02683/> accessed 16 August 2021.

[2] Alasdair Douglas EU tax: moving towards harmonisation, Euro Law 2001, 10, 51 (53).

[3] Dirk Leuffen, Berthold Rittberger and Frank Schimmelfennig *'Differentiated Integration. Explaining Variation in the European Union: The European Union Series'* (Palgrave macmillan 2013) 150-151.

[4] Alex Barker and Vanessa Houlder, 'How Juncker and Luxembourg landed Silicon Valley's biggest catch' *The Financial Times* (11 December 2014) <https://www.ft.com/content/78abd184-813c-11e4-896c-00144feabdc0> accessed 7 September 2021.

[5] Rita de la Feria and Clemens Fuest, 'The economic effects of EU tax jurisprudence' (2016) 41(1) EL Rev 44, 52; Article 115 TFEU.

substantial worldwide tax harmonisation remains impractical.[6] The EU also has pre-existing legislation which is currently producing negative harmonisation and legislation which could be used to introduce positive harmonisation. This thesis focuses on EU corporate taxes of Multinational Enterprises (MNEs) because as Chapter One will demonstrate, MNEs are best placed to exploit the differences between tax systems. Further, Chapter Three will show that State aid tax rulings are primarily used by Member States to attract significant investments from large MNEs.

The purpose of this thesis is therefore to understand the different components of EU corporate taxation to determine what the future of corporate tax harmonisation may look like. This includes establishing the short term and long term future of EU corporate tax by determining which areas the European Commission ('Commission') should focus on and whether these areas are subject to change.

To fulfil this purpose, this thesis will answer three research questions:

1. What are the main problems which are derived from the differences in corporate tax systems between Member States?
2. What negative harmonisation has taken place and is negative harmonisation an effective means of corporate tax harmonisation?
3. What would positive harmonisation or integration look like and could it provide a more effective means of corporate tax harmonisation than negative harmonisation?

The chapters largely align with the research questions, with Chapter One addressing the problems, Chapter Two and Chapter Three addressing negative harmonisation through the four freedoms and Article 107 respectively, and Chapter Four addressing the third research question by assessing the potential for positive harmonisation.

This thesis begins by analysing the problems which arise due to the differences between corporate tax systems across the EU. These problems are identified first because the analysis of corporate tax harmonisation presupposes that the current lack of harmonisation is problematic.

[6] Emma Agyemang, Chris Giles and Sam Fleming, 'OECD close to final global deal on corporate tax' *The Financial Times* (Copenhagen, London and Brussels 8 October) <https://www.ft.com/content/3e3e6a7d-67d5-437d-a7b2-29c52ce9c78f> accessed 12 October 2021.

Chapter 1: The Problems Originating from the Coexistence of 27 Corporate Tax Systems

1.1 Introduction

Union intervention in the field of corporate EU tax has received significant attention. The purpose of Chapter One is to justify the attention this topic has received by establishing why each Member State having their own corporate tax system is a problem. This chapter first addresses the problems by considering the costs and burdens caused by all 27 Member States having their own tax systems. These include the costs for MNEs to comply with each system, the costs for tax administrations to enforce their tax rules and finally, the costs and burdens incurred by both MNEs and Member States owing to a lack of transparency between the different corporate tax systems. This chapter then considers tax competition between Member States who wish to compete to secure additional Foreign Direct Investment ('FDI'). This section will also consider the difference between general tax competition and harmful tax competition. Finally, the problem of tax avoidance by MNEs will be considered. This section considers the different ways MNEs attempt to lower their tax liability. This chapter will then address the different methods which can be used to minimise the differences between corporate tax systems in the EU. In particular, negative harmonisation methods such as the free movement case law and State aid controls are discussed and positive harmonisation methods are also discussed. This chapter will consider how the different methods are best suited to tackling different problems.

1.2 The Problems

1.2.1 The Cost of Different Tax Systems

The coexistence of 27 different corporate tax systems in the EU creates costs and burdens for both MNEs and Member States.

1.2.1.1 Compliance Costs

Compliance costs refer to the 'value of resources expended by taxpayers in meeting their tax obligations'.[1] The importance of considering compliance costs when evaluating tax systems has been increasingly recognised in the literature.[2] The increased recognition is because the cost of compliance results in a reduction of the economic resources available to MNEs.[3] There are 27 EU Member States all of whom have different tax systems.[4] As a result, MNEs must comply with each system individually, placing high levels of compliance costs on MNEs.[5]

The greater the variation in tax rules an MNE must comply with, the higher the costs for the MNE to ensure they follow all of the different tax rules. The higher costs are due to the MNE needing specific tax advice for each tax jurisdiction. Compliance costs have therefore been recognised by the EU and by academics as a potential barrier to cross-border investments and cross-border business activity.[6] The high compliance costs can discourage corporations operating in Member States from expanding their economic activities into other Member States which would result in the corporation needing to understand and comply with a completely separate tax system. Therefore, many academics agree that compliance with each individual system incurs higher costs than compliance with a single system would.[7]

The argument that compliance with a single system would incur fewer costs relies on the assumption that the rules of a combined approach would be simpler.[8] Currently, each Member State has different tax rates, different tax bases, different rules concerning foreign

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[1] Binh Tran-Nam and others, 'Tax Compliance Costs: Research Methodology and Empirical Evidence from Australia' (2000) 53(2) National Tax Journal 229-252.
[2] Jan Pavel and Leoš Vítek, 'Tax Compliance Costs: Selected Post-transitional Countries and the Czech Republic Procedia' (2014) 12 J Econ Finance 508, 509.
[3] Sebastian Eichfelder and Frank Hechtner, 'Tax Compliance Costs: Cost Burden and Cost Reliability' (2018) 46(5) Public Finance Review 764, 765.
[4] European Union, 'Countries' (*Europa)* <https://europa.eu/european-union/about-eu/countries_en> accessed 1 April 2021.
[5] Zoltán Pitti and Magdolna Sass, 'Tax competition and coordination within the EU — the case of the EU-10' (2010) 16(1) Transfer: European Review of Labour and Research 37, 47; Antony Ting, 'Base erosion by intra-group debt and BEPS project action 4's best practice approach - a case study of Chevron' [2017] BTR 80, 99.
[6] Salvador Barrios, Diego D'Andria and Maria Gesualdo, 'Reducing tax compliance costs through corporate tax base harmonization in the European Union' (2020) 41 JIAAT 100355.
[7] Christiana HJI Panayi, 'Reverse subsidiarity and EU tax law: can Member States be left to their own devices?' [2010] BTR 267, 277; William J Craig and Ajay Kumar, 'Tax harmonisation for Europe and the world: could the ECJ show the way?' (2007) 18(10) ICCLR 341, 345-47.
[8] Sjoerd Douma, 'Limitations on Interest Deduction: an EU Law Perspective' [2015] BTR 364, 368-69.

income and some Member States also have multiple local taxes.[9] Therefore, further harmonisation in this area will make it easier for MNEs to deal with the different tax systems by reducing the differences between the corporate tax systems of different Member States and hence lower the compliance costs associated with cross-border trade in the single market.

When analysing compliance costs, the difference between small and medium-size corporations compared to large corporations is often recognised.[10] If the lack of tax harmonisation prevents or discourages smaller corporations from cross-border activities this would be contrary to the purpose of the single market.[11] This disproportionate effect is not due to larger MNEs having different or fewer compliance costs. Compliance costs are incurred by MNEs of all sizes.[12] The disproportionate effect is instead because smaller MNEs will have lower revenues and therefore the compliance costs are a higher percentage of their overall turnover compared to large MNEs. Many of the corporate tax compliance costs can be considered fixed costs.[13] The larger MNEs do not, therefore, see their costs grow in proportion to their internal growth. For smaller MNEs or corporations who have not yet engaged in cross-border activity, the cost of complying with different tax systems may exceed their predicted profit of engaging in cross-border activity.

1.2.1.2 Enforcement Costs

The coexistence of 27 different tax systems has resulted in increased enforcement costs such as administrative costs. Administrative costs are the costs to tax authorities and governments of collecting taxes.[14] The level of expenditure required by tax authorities when collecting tax has an effect on the overall public budget of the Member State.[15] This section will also

[9] Wolfgang Schön, Ulrich Schreiber and Christoph Spengel, *A Common Consolidated Corporate Tax Base for Europe* (1st edn, Berlin Springer 2010) 24.
[10] Antony Ting, 'Creating Interest Expense Out of Nothing at All - Policy Options to Cap Deductions to "Real" Interest Expense' [2018] BTR 589, 599.
[11] Craig and Kumar (n 7).
[12] Mattias Levin and Karel Lannoo, 'An EU Company without an EU Tax?' (2002) CEPS Research Report 1 April 2002 < https://www.ceps.eu/download/publication/?id=4459&pdf=39.pdf> accessed 5 April 2021.
[13] Popi Fauziati and Aza Azlina Md Kassim, 'The effect of business characteristics on tax compliance costs' (2018) 8(5) Management Science Letters 353.
[14] Tran-Nam and others (n 1).
[15] Břetislav Andrlík, 'Corporation Income Tax and Administrative Costs of the Public Sector' (2015) 63(1) Acta Univ Agric et Silvic Mendelianae Brun 165, 167.

discuss the burden associated with the insufficient collection of corporate taxes which arise due to the lack of transparency when every EU Member State has a different tax system.

The complexity of taxing MNEs has widened the gap between collected and potential corporation tax. The lack of transparency and coordination between Member States has been recognised with increased measures at EU level aimed at increasing transparency.[16] For example, the Anti-Tax Avoidance Package was announced in 2016.[17] One key aspect of the Anti-Tax Avoidance Package is the revised Directive on cooperation. The Directive would require country-by-country reporting by Member States on the tax treatment of MNEs in the EU.[18]

Sandra Eden defines tax rules as lacking transparency 'where there is a gap between what a jurisdiction formally does, and the practice of its tax authorities'.[19] For example, a tax jurisdiction may have formal rules which appear to tackle the use of artificial prices for transfer pricing. However, in practice, the tax authority may be lenient towards MNEs using artificial prices. Other tax jurisdictions will not know how the tax jurisdiction will rule on a particular matter due to the divergence from the formal tax rules. However, this gap is not necessarily a choice for Member States. For example, in the previous section, the difficulties of tackling artificial prices for transfer pricing involving intangible assets was discussed. The need for increased coordination due to the differences between the different tax systems of the EU is recognised in the literature.[20] Malcolm Gammie named the complexity 'both conceptually and administratively' of corporate tax as one of the four reasons corporate tax regimes currently 'fail'.[21] Failure in this context refers to the gap between the benefits that successful corporate tax regimes would have and the current benefits gained from corporate tax regimes.

There are a number of situations where tax authorities may not know the tax rulings of other Member States. When calculating tax, Member States may also not know the tax rulings a corporation has been given by a third country. This can be relevant in situations where

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[16] Anzhela Cédelle, 'The EU Anti-Tax Avoidance Directive: a UK perspective' [2016] BTR 490, 490.
[17] Commission, 'Fair Taxation: Commission presents new measures against corporate tax avoidance Brussels' Press Release 28 January 2016 <https://ec.europa.eu/commission/presscorner/detail/en/IP_16_159> accessed 25 April 2021.
[18] Commission, 'Proposal for a Council Directive amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation' COM (2016) 25 final.
[19] Sandra Eden, 'Corporate tax harmonisation in the European Community' [2000] BTR 624, 631-33.
[20] Cédelle (n 16) 493.
[21] Malcolm Gammie, 'Taxing corporate profits in a global economy' [2013] BTR 42, 42-43.

Member States are trying to prevent double-non taxation. The importance of tax transparency as an international issue can be seen in the OECD's decision to prioritise transparency.[22] The issue of larger MNEs engaging in debt shifting and benefitting in two different countries from both tax reductions for interest payments and dividend exemptions is one example of where a lack of transparency can cause Member States to collect a lower amount of tax.[23] If the EU moved towards a more harmonised corporate tax system then for intra-community transactions, tax authorities would be in a better position to enforce their tax rules. The lack of corporate tax harmonisation acts as a barrier to transparency and coordination. As a result, MNEs with operations in at least two Member States are able to exploit the differences in the tax systems and low their tax burden.

The lack of transparency between the different tax administrations in the EU can also be problematic for MNEs as it can lead to double taxation. Double taxation is where the same profit is taxed more than once in different jurisdictions.[24] Different Member States will have different rules as to what profit they tax. The risk of the same profit being taxed twice is overcome by double taxation treaties. These treaties allow different jurisdictions to cooperate with each other and decide how to allocate the right to tax to ensure that they do not tax the same profit.[25] However, not every combination of Member States is covered by a double taxation treaty. Therefore, it is possible for an MNEs' profit to be considered taxable profit in every Member State. This means that the lack of transparency is also harmful to MNEs.

The compliance costs in conjunction with the administrative costs show that the lack of tax harmonisation places unnecessary burdens on both the Member States who collect less tax and the MNEs who have to deal with larger compliance costs. A system that improves transparency and simplifies compliance would benefit both Member States and MNEs.

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[22] Edoardo Traversa and Alessandra Flamini, 'The Impact of BEPS on the Fight Against Harmful Tax Practices: Risks... and Opportunities for the EU' [2015] BTR 396, 396-97.
[23] Alexander Rust, 'BEPS Action 2: 2014 Deliverable - Neutralising the Effects of Hybrid Mismatch Arrangements and its Compatibility with the Non-discrimination Provisions in Tax Treaties and the Treaty on the Functioning of the European Union' [2015] BTR 308, 309.
[24] Paul L Baker, 'An Analysis of Double Taxation Treaties and their Effect on Foreign Direct Investment' (2014) 21(3) Int J Econ Bus 341, 341.
[25] Eckhard Janeba, 'Corporate income tax competition, double taxation treaties, and foreign direct investment' (1995) 56(2) Journal of Public Economics 311, 322.

1.2.2 Tax Competition

Tax competition between Member States is another problem that is derived from each Member State having their own corporate tax system. Tax competition can be divided between general tax competition and tax competition with harmful tax practices.

2.3.2.3 General Tax Competition

Joachim Englisch and Anzhela Yevenyeva define tax competition as 'a process of uncooperative but interdependent setting of tax rates between jurisdictions that enjoy tax autonomy'.[26] Tax competition is the main cause of the fall in corporate tax rates which has been seen both in the EU and the world.[27] The lack of harmonisation between Member States encourages tax competition as Member States are in competition to offer the most competitive tax rates.[28] The consensus is that a Member State with a competitive tax rate will have more FDI than if their tax rate was higher.[29] FDI is what Member States are in competition for.[30] One reason increased levels of FDI is desirable for many Member States is because it can lead to increased levels of employment.[31] The internal market and the four freedoms have heightened the level of tax competition between Member States.[32] The existence of a broad range of Member States with lower corporate tax rates places downward pressure on Member States whose corporate tax rates are not as low.[33] As a result, the corporate tax rates of Member States are pushed closer to each other.[34] MNEs are able to choose the Member State which suits their needs. MNEs are assumed to want to maximise their profits and tax rates, therefore, form part of their decision. Corporate tax competition is generally considered to have a positive effect on the EU as it keeps the internal market and

[26] Joachim Englisch and Anzhela Yevgenyeva, 'The "Upgraded" Strategy Against Harmful Tax Practices Under the BEPS Action Plan' [2013] BTR 620, 621.
[27] ibid 622.
[28] Velida Pearce, 'Exiting the fiscal maze' [2003] Euro Law 25, 25.
[29] Brady Gordon, 'Tax competition and harmonisation under EU law: economic realities and legal rules' (2014) 39(6) EL Rev 790, 791.
[30] Ioan Talpoş and others, 'Fiscal decentralization and tax competition in the eu member states' (2011) 2 ECECSR 80, 84.
[31] Ioan Cosmin Pițu, Bianca Cristina Ciocanea and Mihaela Luca, 'The Impact of Tax Competition and Harmonisation in the EU in Relation to Fiscal Optimisation' (2018) 28(2) Annals of the University of Oradea: Economic Science 109, 111.
[32] Cédelle (n 16) 493.
[33] Carissa L Tudor and Hilary Appel, 'Is Eastern Europe to Blame for Falling Corporate Taxes in Europe?: The Politics of Tax Competition Following EU Enlargement' (2016) 30(4) EEPS 855, 857.
[34] Michela Redoano, 'Tax competition among European countries. Does the EU matter?' (2014) 34 European Journal of Political Economy 353, 355.

each Member State competitive for investment.[35] However, the belief that tax competition leads to more competitive conditions in Member States is not universally supported.

The competitive advantage gained from lowering the overall corporate tax rate is argued to disappear when other Member States, or third countries, also lower their taxes.[36] When Member States lower their tax rates at a similar pace to all other Member States there is unlikely to be a significant increase in the amount of investment they attract. Subsequent benefits which have been attributed to tax competition such as increased levels of employment do not therefore follow. Tax competition has also been criticised for shifting the tax burden onto factors that are either immobile or have very low mobility such as labour and small firms.[37] The shift then reduces the competitiveness of the Member State before ultimately leading to fewer provisions of public goods due to the reduction in tax revenues.[38] However, this welfare argument has been criticised for relying on 'empirically problematic' hypotheses.[39] The criticism concerns the lack of knowledge available about the number of public goods that society wants and that society needs. Since this information is not available, any welfare argument stating that a reduction in public goods is a negative effect of tax competition cannot be fully supported by evidence.

Additionally, the argument that tax competition shifts the tax burden and leads to fewer provisions of public goods also ignores the evidence that Member States have maintained their corporate tax revenues through expanding their tax bases.[40] When a Member State expands their tax base, the Member State increases the number of taxable activities. Through taxing a greater variety of activities and goods, the Member State is able to increase its tax revenues. When a Member State expands their tax base (thereby increasing tax revenues) and also lowers their corporate tax rate at the same time (thereby decreasing tax revenues), Member States are able to maintain similar levels of tax revenues because the changes to tax revenues cancel each other out.

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[35] Ioanna Mitroyanni, 'The common consolidated corporate tax base: accomplished steps and the way ahead' [2011] BTR 246, 251.
[36] Julie A Roin, 'The economic underpinnings of international taxation' in Andrew T Guzman and Alan O Sykes (eds), *Research Handbook in International Economic Law* (Edward Elgar 2007) 336.
[37] Englisch and Yevgenyeva (n 26) 623; Gordon (n 29) 793.
[38] Gordon (n 29) 793.
[39] George E Halkos and Nickolas C Kyriazis, 'Is tax competition harmful and is the EU an optimal tax area?' (2006) 21(2) Eur J Law Econ 163, 170.
[40] OECD, 'Corporate Tax Revenues' (OECD Stat) <https://stats.oecd.org/Index.aspx?DataSetCode=CTS_REV> accessed 14 April 2021.

Tax competition can also produce distortive effects if a Member State has a corporate tax rate that is significantly higher than other Member States.[41] Within the internal market, corporations have lower barriers to moving their operations to another Member State or engaging in cross-border transactions due to the freedom of establishment.[42] However, lower barriers to cross-border trade do not always result in increased tax competition. Studies have suggested that where the reduction in trade barriers is linked to advancements in infrastructure, tax competition does not necessarily increase.[43] Furthermore, as has already been established, there is a range of locational factors which affect an MNEs decision on where to invest, such as the quality of the available labour force, and the quality of infrastructure.[44] Since the corporate tax rate is not the only factor that forms part of a decision on the location of MNEs operations, unless the tax rate was significantly higher than all of the other Member States who had similar levels of infrastructure, the distortive effects on tax competition will not be seen.

Tax competition has also been criticised for lowering Member States' corporate tax revenues due to the pressure placed on Member States to lower their corporate tax rates. For example, the UK's decision to lower its tax rate to 17% was attributed to tax competition.[45] However, this concern ignores the fact that Member States which lower their corporate tax rates often expand their corporate tax bases. Expanding the corporate tax base when reducing corporation tax rates is recognised to have a neutral effect on the overall corporation tax revenue.[46] Research into the effect of tax competition in the EU on corporation tax revenue has shown that the revenue has remained largely neutral despite a large overall fall in the tax rate.[47] The trend among EU Member States to lower their tax rate while expanding their base is also expected to continue in the absence of any major EU tax reform.[48]

Tax competition has also been criticised because Member States who do not participate may find that they lose out on investment which then increases their unemployment rates and contributes to a decline in industries.[49] However, there are several different locational factors

[41] Gordon (n 29) 792-93.
[42] Philipp Genschel, Achim Kemmerling and Eric Seils, 'Accelerating Downhill: How the EU Shapes Corporate Tax Competition in the Single Market' (2011) 49(3) JCMS 585, 586.
[43] Johannes Becker and Clemens Fuest, 'EU regional policy and tax competition' (2010) 54(1) European Economic Review 150, 160.
[44] Frank Barry and Rosemary Healy-Rae, 'FDI implications of recent European Court of Justice decisions on corporation tax matters' (2010) 11(1) EBOR 125, 126.
[45] Cédelle (n 16) 505.
[46] Gordon (n 29) 793.
[47] ibid 795.
[48] Josh White, 'US tax reform: The tax competition risks to the Netherlands and EU' [2018] International Tax Review (3/19/2018).
[49] Craig and Kumar (n 7) 343.

that affect where an MNE invests. All of the different locational factors must be considered when discussing the effect that tax competition between Member States has on each individual Member State.

Tax competition has been recognised to help smaller Member States who may not have the same infrastructure as larger Member States.[50] Many smaller Member States would not be able to compete for investment if they were unable to rely on tax competition. Some of the larger Member States may therefore be able to compete on the basis of other factors such as infrastructure and proximity to clients. Therefore, removing the differences between the tax rates of Member States would not create a fairer or more level playing field. Instead, it would widen the gap between the wealthier Member States and the poorer Member States.[51] Larger Member States are able to benefit as a result of their size because their population size offers increased incentives for investment.[52] Their larger population represents a larger potential consumer base which acts as an incentive for MNEs looking to invest because the potential revenue that could be generated in a country with a larger population will be higher than in a country with a lower population.[53]

In conclusion, the benefits of corporate tax competition are exaggerated as they do not take into account that other Member States are likely to respond by lowering their corporate tax rates. However, where larger and more economically developed Member States do not lower their tax rates, they are unlikely to suffer substantial harm due to the number of different locational factors which can influence an MNEs decision on where to invest. The potential for distortive effects due to corporate tax competition in the absence of harmful tax practices is limited. Such distortive effects will not appear unless a Member State introduces a tax rate that is substantially higher than other Member States with similar economies.

1.2.2.2 Identifying Harmful Tax Practices

Tax competition between Member States may include harmful tax practices. The purpose of harmful corporate tax competition is largely the same as general corporate tax competition. Member States believe that through certain tax measures they will increase investment.[54] There is no consensus among policymakers or academics about the exact definition of

[50] Gordon (n 29) 798-99.
[51] Ivan Ozai, 'Tax Competition and the Ethics of Burden Sharing' (2018) 42(1) Fordham Int'l LJ 61, 79.
[52] Zaif Hassan Fazal, 'Tax Competition: A Blessing in Disguise for Small Countries' (2020) 22 J Austl Tax'n 60, 75.
[53] ibid.
[54] Alasdair Douglas, 'A taxing problem for EU accession states' [2003] Euro Law 29, 30.

harmful tax competition.[55] However, there is a broad consensus that corporate tax regimes which favour particular corporations or industries are harmful.[56] Harmful corporate tax competition can therefore be differentiated from general corporate tax competition on the basis of preference or specificity. A policy that enacts general low corporate tax rates does not fall within the definition of regimes or practices which may be harmful.[57]

The OECD lists five key factors and another five other relevant factors which can suggest that a tax regime is harmful.[58] The five key factors include regimes that impose no, or very little, effective tax rates for 'geographically mobile' services, regimes that are separate from those available for the domestic economy, a lack of transparency, a lack of effective information exchanged and where the regime does not require 'substantial activities'.[59] The five other factors concern a tax base definition which is artificial, non-compliant with 'international transfer pricing principles', income from abroad being exempt from taxation, tax rates or tax abuses which are negotiable and secrecy provisions.[60] The EU uses similar factors for their criteria of corporate tax practices which are 'potentially harmful'.[61] The criteria include regimes where the 'effective level of taxation is significantly lower' than that of the general taxation in the Member State, separate tax benefits for non-residents, tax incentives that have no impact on the Member States' tax base, tax advantages without any real economic activity, where profit determination for MNEs does not correspond with OECD or international rules and where there is a lack of transparency.

The large overlap between both criteria and the number of different factors allows both the OECD and the EU to ensure many different tax regimes fall within their scope. They can then investigate each tax rule on their merit. Member States know that the EU will act if it finds a tax regime that is harmful. However, this has not necessarily stopped harmful tax practices but instead changed the nature of Member States' harmful tax regimes. Harmful tax practices both within the EU and across the world are increasingly hard to identify as Member States will increasingly design them to escape the criteria outlined above. Preferential tax regimes can be enacted without a clear legal basis by relying on the

[55] Englisch and Yevgenyeva (n 26) 622.
[56] Traversa and Flamini (n 22).
[57] Eden (n 19).
[58] OECD, 'Harmful Tax Practices - 2018 Progress Report on Preferential Regimes: Inclusive Framework on BEPS: Action 5, OECD/G20 Base Erosion and Profit Shifting Project' (OECD Publishing 2019 <https://doi.org/10.1787/9789264311480-en> accessed 24 April 2021) 15.
[59] ibid.
[60] ibid.
[61] Traversa and Flamini (n 22) 400-01.

discretion of tax authorities within the Member State.[62] As a result of the tax regime not being enshrined in law, those trying to establish proof of harmful practices will find it more difficult to collect evidence and there may be a delay in tackling the regime.

Many Member States have introduced tax incentives linked to research and development, such as patent boxes.[63] A patent box is a tax scheme that allows the revenues derived from patents to be taxed differently from other revenues. The patent revenues receive favourable tax treatment which encourages patent creation. Incentives for research and development have the potential to advance science and encourage innovation.[64] Tax regimes specifically aimed at research and development allow Member States to ensure that their economies are able to continually attract Intellectual Property ('IP') income and stay competitive.[65]

However, even where Member States have intended for their tax incentives to encourage research and innovation, many of them instead manifest as harmful tax regimes which offer advantages for foreign MNEs who have no real or genuine link to the Member State.[66] The tax incentives become harmful because they offer preferential tax treatment which means that some industries are able to benefit more than others. In addition, where the tax incentives do not require the patent research to have been conducted in the same jurisdiction, MNEs can use patent box tax incentives to benefit from preferential tax treatment for patents developed in other jurisdictions. As a result, the tax jurisdiction where the patent was developed is unable to tax the patent revenues and the new jurisdiction does not benefit from increased research and development.

As a result, MNEs use these regimes to relocate their taxable profits away from the jurisdiction in which their research was carried out. The EU initially sanctioned several of

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[62] Traversa and Flamini (n 22) 398.
[63] Annette Alstadsæter and others, 'Patent boxes design, patents location, and local R&D' (2018) 33(93) Economic Policy 131, 133ff.
Kate Alexander, 'Analysis – UK patent box: fair competition or a harmful tax practice?' [2013] Tax Journal 11, 12 < https://www.taxjournal.com/articles/uk-patent-box-fair-competition-or-harmful-tax-practice-07112013> accessed 20 April 2021.
[64] Wim Eynatten and André Schaffers, 'Tax competition to attract and keep IP income remains alive' (2013) 24(3) International Tax Review 20 < https://web-a-ebscohost-com.ezphost.dur.ac.uk/ehost/detail/detail?vid=0&sid=ff1eb42c-1660-49fc-8b9e-247ef8d2045e%40sessionmgr4006&bdata=JnNpdGU9ZWhvc3QtbGl2ZQ%3d%3d#AN=87057634&db=bah> accessed 20 April 2021.
[65] Wim Eynatten and Patrick Brauns, 'Benelux tax competition to attract IP income is on again' (2010) 21(2) International Tax Review 43 < https://web-b-ebscohost-com.ezphost.dur.ac.uk/ehost/detail/detail?vid=0&sid=d1f078d5-4b8a-46c1-9c1e-d0d899d99810%40pdc-v-sessmgr01&bdata=JnNpdGU9ZWhvc3QtbGl2ZQ%3d%3d#AN=49017634&db=bah> accessed 17 April 2021.
[66] Traversa and Flamini (n 22) 401.

these regimes.[67] The effectiveness of these research and development incentives in actually attracting and encouraging genuine research and development is highly dependent on a range of other factors including the availability of a research and development workforce.[68]

The UK Government introduced the UK Patent Box in 2013 with the reported aim of encouraging research and investment.[69] Corporations who chose to opt out of the scheme were prevented from re-joining the scheme for another five years and those who opted in were prevented from withdrawing and then re-joining depending on which options would maximise their profits each year.[70] These rules were designed to prevent the UK Patent Box regime from being manipulated by MNEs. The UK Patent Box was also deemed to be less competitive than other similar regimes available in other Member States such as the Netherlands.[71] The decision to introduce a Patents Box which was less competitive than many available in other Member States was seen as a deliberate decision to ensure that the UK was not seen as a tax haven.[72] Other measures such as the ownership requirements also deterred MNEs from abusing the regime.[73] These requirements mean that in an MNE group company, the tax entity which benefits from the scheme must have some degree of control over the patents. The exact requirements will vary depending on the individual tax regime. The ownership requirements make it more difficult for MNEs group companies to benefit from the scheme without holding patents in the relevant jurisdiction. The European Commission criticised the UK Patent Box arguing that it contained several harmful policies and called for all patent box regimes to be investigated.[74] In 2014, the UK and Germany

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[67] ibid.
[68] Catalina Cozmei and Margareta Rusu, 'The EU Tax Treatment Competition for Knowledge Based Capital – The Special Case of R&D' (2015) 32 Procedia Economics and Finance 817, 819.
[69] Chris Adriaanse, 'Government plans patent box (UK tax reform)' [2010] Journal Chemistry and Industry 5.
[70] Niall McAlister, 'The UK patent box' (2011) 23(11) Intellectual Property & Technology Law Journal 21, 22.
[71] Wendy Nicholls and Paul Smith, 'Questions raised on the new UK patent box' [2011] 22(8) International Tax Review <https://www.internationaltaxreview.com/article/b1fbs4225ljrnq/questions-raised-on-the-new-uk-patent-box> accessed 20 April 2021.
[72] Mary Ashley, 'Measuring the dimensions of the UK Patent Box' [2013] 24(2) International Tax Review < https://web-b-ebscohost-com.ezphost.dur.ac.uk/ehost/detail/detail?vid=0&sid=6f41de4a-8b65-424f-a571-0ad8683e5155%40pdc-v-sessmgr01&bdata=JnNpdGU9ZWhvc3QtbGl2ZQ%3d%3d#AN=86383848&db=bah> accessed 20 April 2021.
[73] David Wilson and others, 'Making the most of the new UK "patent box" tax regime' (2013) 35(3) EIPR 175, 177.
[74] Council of Europe, 'Press Release 3281st Council meeting Economic and Financial Affairs' Press Release 10 December 2013

proposed an amendment to the OECD's rules governing Patent Box regimes.[75] The proposal, which was accepted, emphasised a link between the Member State and where the MNEs invested in research and development. The UK agreed to alter the design of their patent box.[76] However, due to the initial design of the UK's 2013 Patent Box, the changes were much smaller than similar schemes in many other Member States.[77]

Corporate tax competition with harmful tax practices where preferential treatment is given to a particular industry is widely considered to be harmful.[78] Corporate tax measures which are aimed at attracting foreign capital are seen as harmful in international tax competition because they lead to a loss of revenue in some countries and have the effect of making national tax regimes more reliant on immobile factors of production (resources which cannot easily relocate to other jurisdictions).[79] This occurs since the relocation of mobile factors of production to low-tax Member States will leave the original Member State few options other than addressing the overall reduction of tax revenues by increasing the tax burden of immobile factors. Capital is 'highly mobile' and comparatively 'high rates of corporate tax' therefore has a higher risk of leading to companies relocating than comparatively higher rates for taxes on less mobile factors.[80] Additionally, retaliatory actions by the original Member State are likely to occur since choosing not to retaliate through enacting similar preferential tax regimes would likely lead to a reduction in their tax base.[81] Many of the negative effects seen in general corporate tax competition are also present when Member States enact corporate tax competition through harmful practices.

The increase in the competitiveness of the internal market was discussed as a benefit of general tax competition. However, since harmful tax competition involves preferential tax

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<https://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/140041.pdf> accessed 16 April 2021.

[75] OECD, 'OECD/G20 Base Erosion and Profit Shifting Project, Action 5: Agreement on Modified Nexus Approach for IP Regimes' OECD, 3 < https://www.oecd.org/ctp/beps-action-5-agreement-on-modified-nexus-approach-for-ip-regimes.pdf> accessed 15 April 2021.

[76] Aredhel Johnson, 'The beginning of the end for the UK Patent Box?' (2015) 10(3) JIPLP 152, 152.

[77] Helen Miller and Thomas Pope, 'Corporate Tax Changes under the UK Coalition Government (2010–15)' (2015) 36(3) Fiscal Studies 327, 334.

[78] Rosa Greaves, 'Autonomous regions, taxation and EC state-aid rules' (2009) 34(5) EL Rev 779, 781.

[79] Veronika Sobotková, 'Revisiting the debate on harmful tax competition in the European Union' (2012) 60(4) Acta Univ Agric et Silvic Mendelianae Brun 343, 345.

[80] Jukka Snell, 'Who's Got the Power? Free Movement and Allocation of Competences in EC Law' (2003) 22 (1) YEL 323, 335.

[81] Claudio M Radaelli, 'Harmful Tax Competition in the EU: Policy Narratives and Advocacy Coalitions' (1999) 37(4) JCMS 661, 670.

treatment for certain industries and corporations, it does not make the internal market more competitive and is harmful to competition in the internal market. The other benefit of general tax competition, enabling smaller Member States to compete for FDI, is also a benefit of harmful tax competition. Smaller Member States using preferential tax regimes specifically aimed at certain industries are likely to attract FDI over other larger Member States who have better infrastructure but offer no preferential tax regime. However, smaller Member States are not able to increase their overall competitiveness through harmful tax practices.

The overall impact of tax competition using harmful tax practices on both the EU's internal market and on individual Member States is therefore negative.

1.2.3 Tax Avoidance

The final category of problems is tax avoidance by MNEs which are corporations that operate in at least two countries.[82] Tax avoidance by MNEs does not have a universal definition. This thesis, therefore, uses the definition offered by Richard L Dorenberg, Luc Hinnekens, Walter Hellerstein and Jinyan Li who defined it as 'the reduction or avoidance of tax by taxpayers through entering into transactions or arrangements in a lawful fashion'.[83] The techniques MNEs use are derived from legal loopholes resulting from the lack of harmonisation of corporate tax regimes.

Since MNEs operate in at least two countries they are able to move their capital to different Member States through their subsidiaries. As such, they are able to respond to the differences between the Member States' tax systems. However, the fact that MNEs have the capability to move capital easily does not mean that tax is a significant locational factor. A locational factor refers to a factor that influences where MNEs decide to migrate and where they decide to invest. It is generally accepted that the tax an MNE will have to pay will form part of their decision making when deciding which Member State to relocate to.[84] Although tax is a locational factor for MNEs, there is still some disagreement surrounding the extent of its significance.

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[82] Ambareen Beebeejaun, 'The fight against international transfer pricing abuses: a recommendation for Mauritius' (2019) 61(1) Int JLM 205, 205.
[83] Richard L Dorenberg and others, *Electronic Commerce and Multijurisdictional Taxation* (2nd edn Kluwer Law International 2001) 89.
[84] Eden (n 19) 624; Malcolm J Gammie, 'Corporate taxation in Europe - paths to a solution' [2001] BTR 233, 233-34; Craig and Kumar (n 7) 344-45.

Peter Cussons states that 'tax differences among Member States distort foreign location decisions' of MNEs.[85] Taxes represent a cost and therefore it follows that tax has the potential to act as a locational factor. However, the effect of tax on the decisions of MNEs to move their assets or capital should not be overstated. It is certainly not the only factor that can be linked to costs. Frank Barry and Rosemary Healy-Rae offer a more restrained view by acknowledging that 'the evidence is unequivocal' but only 'in circumstances where other locational factors… are similar' can 'a lower rate of corporate tax serve as a powerful tool to attract mobile international capital'.[86] This more cautious approach helps to capture the economic reality of the decision making process for Member States. The significance of tax as a locational factor relies on other locational factors such as infrastructure being similar in each jurisdiction.

Alasdair Douglas offers a contrasting view that the directors in charge of MNEs make their decision of where to invest irrespective of the tax environment and then instruct their advisers to 'structure the investment in as tax-efficient a manner as is feasible.'[87] He suggests that the decisions surrounding tax are an afterthought that takes place after a director has already chosen where to invest. His argument that it is not a 'critical' factor is convincing since there are many different factors including the skillset of the labour force which could impact the likely financial success of an MNEs' investment. However, Douglas understates the importance of tax when it involves the comparison of two similar Member States. In this instance, tax is inevitably going to be an important factor since the other locational factors will be neutral. Therefore, while tax is not the only significant factor in locational decisions it is one of the main factors which will influence decision making due to its impact on MNEs' costs.

When MNEs want to take advantage of tax differences between the different EU Member States, they do not have to physically move their factories or offices. As Brady Gordon characterises it, profit shifting is where a 'company can react to taxation without making a significant shift in its physical plant'.[88] Profit shifting, which includes both transfer pricing and debt shifting,[89] therefore enables MNEs to lower their tax rates without actually physically moving their businesses.

[85] Peter Cussons, 'The Parent-Subsidiary and Mergers Directives' [1993] BTR 105, 111-12.
[86] Barry and Healy-Rae (n 44).
[87] Alasdair Douglas, 'Harmonisation in a minor key' (2001) 1(8) Euro Law 27, 28.
[88] Gordon (n 29) 792.
[89] Salvador Barrios and Diego d'Andria, 'Profit shifting and industrial heterogeneity' (2020) 66(2) Economic Studies 134, 138ff.

1.2.3.1 Transfer (Mis)Pricing

Transfer pricing is the internal price in intra-group transactions.[90] Intra-group transactions refer to situations where two subsidiaries of the same parent company enter into contracts with each other, or where a subsidiary enters into a contract with the parent company. In Luc Hinnekens analysis of transfer pricing, he characterises intra-group transactions as being 'easily manipulated' because of the 'largely artificial separation' between subsidiaries of the same group.[91] Since subsidiaries are part of the same group, they will be controlled by the same parent company and so they are not entirely separate.

Transfer pricing is not a new issue and was mentioned in the 1995 OECD report which set out guidelines for OECD members to follow when assessing whether transfer prices were acceptable.[92] As such, many transfer pricing rules have been developed which seek to prevent prices that are considered to be artificially high or low.[93] Artificial prices used in transfer pricing cause distortions, by providing an advantage to selected market participants through reduced costs, which is why the rules require intra-group transactions to be priced at the same level that would be seen with two independent market participants.[94] The use of artificial prices in transfer pricing is referred to as transfer (mis)pricing. Artificial prices are assumed to serve the purpose of tax minimisation and profit maximisation.[95] The general consensus however is that the existing rules within the EU are not sufficient for tackling transfer pricing as many MNEs are still able to benefit from using artificial prices through using transfer pricing.[96]

Distortions occur in the absence of free and fair competition.[97] Artificial prices cause distortions because they distort the competition between different corporations because some MNEs will be able to benefit more from artificial prices than others. For example, MNEs who have highly or completely unique products are more able to escape the transfer pricing

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[90] Beebeejaun (n 82) 206.
[91] Luc Hinnekens, 'The European Tax Arbitration Convention and its legal framework: Part 1' [1996] BTR 132, 132-33.
[92] OECD 'Transfer Pricing Guidelines For Multinational Enterprises And Tax Administrations' (The Committee on Fiscal Affairs Organisation for Economic Co-Operation and Development 1995) Draft Text Of Part Ii <http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=OCDE/GD(95)31&docLanguage=En> accessed 19 March 2021.
[93] Dorenberg and others (n 83).
[94] Veronika Solilová, 'Transfer pricing rules in EU member states' (2010) 58(3) Acta Univ Agric et Silvic Mendelianae Brun 243, 244-245.
[95] Dorenberg and others (n 83); Beebeejaun (n 82) 206, 211.
[96] Barry and Healy-Rae (n 44) 127.
[97] Timothy Meyer, 'Free Trade, Fair Trade, and Selective Enforcement' (2018) 118(2) Columbia Law Review 491, 564ff.

rules.[98] Reviews of an MNEs transfer pricing practice would involve assessing whether the price used in intra-group transactions was equal to the price of the same transactions between unrelated corporations.[99] However, when an MNE owns a unique product there is no genuine comparison for tax authorities to rely on. An MNE could therefore benefit from transfer pricing while still operating within the law.[100] Intangible products, such as IP rights, are of growing importance to tax authorities.[101] Intangible products are increasingly able to facilitate artificial pricing for MNEs' transfer prices. Since intangible products are usually unique they are subsequently hard to value.[102] Intangible assets are also very mobile.[103] They do not physically exist and as a result, they can be transferred between subsidiaries of the same group company easily.

MNEs can benefit not just from the tax rates of different Member States but also the different rules concerning what is actually taxed. Timothy Lyon's analysis of Apple Inc's tax structure demonstrates that the subsidiaries of Apple Inc who were not registered in Ireland only paid corporation tax on their transactions conducted in Ireland.[104] The subsidiaries which were resident in Ireland did not have rights to the IP licenses. Through designing their company structure carefully, Apple Inc paid very few taxes. The analysis of Apple Inc demonstrates an additional problem with valuing some intangible assets. Intangible assets which are associated with a brand, such as a logo, will be especially hard to value. They are hard to value because, in addition to a brand like Apple being unique, the brand may fluctuate more easily than the value of a piece of technology.

Antony Ting conducted a similar analysis for Amazon.com Inc which demonstrates the complexity of IP migration.[105] Amazon.com Inc entered into three different agreements with a wholly-owned subsidiary in Luxembourg. The analysis of Amazon.com Inc demonstrates the difficulties of valuing technology-focused intangible assets.[106] Amazon's own staff could

[98] Antony Ting, 'Intangibles and the Transfer Pricing Reconstruction Rules: A Case Study of Amazon' [2020] BTR 302, 302-03.
[99] Jamie Elliott, 'Developments in transfer pricing' [1995] BTR 348, 349.
[100] Barry and Healy-Rae (n 44) 127.
[101] Wolfgang Schön, 'Transfer Pricing Issues of BEPS in the Light of EU Law' [2015] BTR 417, 417-18.
[102] Grantley Taylor, Grant Richardson and Roman Lanis, 'Multinationality, tax havens, intangible assets, and transfer pricing aggressiveness: an empirical analysis' (2015) 14(1) Journal of International Accounting Research 25, 30.
[103] Schön (n 101).
[104] Timothy Lyons, 'Ireland and Apple v European Commission: the competent exercise of competences' [2020] BTR 609, 609-10.
[105] Ting, 'Intangibles and the Transfer Pricing Reconstruction Rules' (n 98) 306-309.
[106] ibid.

not predict Amazon's earnings very far into the future.[107] Tax authorities who are less familiar with Amazon's business will therefore find it difficult to establish a true value for Amazon's products. The difficulty with establishing a true value for Amazon's products means that tax authorities will struggle to determine what is an artificial price. MNEs with technology-focused intangible assets are therefore able to benefit from transfer pricing.

1.2.3.2 Abuse of Debt shifting

The other profit shifting method used by MNEs to lower their tax obligations is debt shifting.[108] Finance shifting can either involve a subsidiary in a high tax jurisdiction financing its activities using debt from other subsidiaries (debt shifting) or it can involve artificially high-interest rate payments.[109] MNEs who use debt shifting are able to benefit from revenue losses and pay less tax.[110] Tax reductions occur because in most countries the interest payments on debt are considered allowable expenses and are therefore deducted prior to determining profits.[111] Returns on equity are usually considered part of the subsidiaries profits and are therefore taxed.[112] MNEs who are heavily financed through debt compared to their equity are referred to as 'thinly capitalised'.[113] MNEs will therefore ensure that the debt belongs to a subsidiary in a high-tax Member State and the subsidiary who loaned the money is in a low-tax Member State.[114] The tax benefits MNEs are able to derive

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[107] ibid.

[108] Antonio Martins, 'The Portuguese corporate tax reform and international trends: an assessment' (2015) 57(4) Int JLM 281, 285; Rita de la Feria and Clemens Fuest 'The economic effects of EU tax jurisprudence' (2016) 41(1) EL Rev 44, 57; Antonio Martins, 'Tax avoidance, anti-abuse clauses and arbitration courts: a note on capital gains' exemption' (2017) 59(6) Int JLM 804, 810.

[109] Ting, 'Base erosion by intra-group debt' (n 5) 80-81.

[110] Jeyapalan Kasipillai and Manoharan Muthiah, 'Thin capitalisation and its impact on taxable income' (2009) 20(8) ICCLR 263, 263; Dirk Schindler and Guttorm Schjelderup, 'Debt shifting and ownership structure' (2012) 56(4) Eur Econ Rev 635, 644-645.

[111] Guttorm Schjelderup, 'The Tax Sensitivity of Debt in Multinationals: A Review' (2016) 23(1) Int J Econ Bus 109, 109; Kasipillai and Muthiah (n 110) 264; Schön (n 101).

[112] Merle M Erickson, Shane M Heitzman and X Frank Zhang, 'Tax-Motivated Loss Shifting' (2013) 88(5) Account Rev 1657, 1660.

[113] Peter Dachs, 'South Africa: Base erosion and profit shifting a[euro]" Debt:equity' [2015] International Tax Review, 19 < https://web-a-ebscohost-com.ezphost.dur.ac.uk/ehost/detail/detail?vid=0&sid=eb502faf-63c4-42b7-8b23-3992c47e7a54%40sessionmgr4008&bdata=JnNpdGU9ZWhvc3QtbGl2ZQ%3d%3d#AN=101615934&db=bah> accessed 22 March 2021.

[114] 'Commission presents new measures against corporate tax avoidance' [2016] EU Focus 27, 28; Edoardo Traversa, 'Interest Deductibility and the BEPS Action Plan: nihil novi sub sole?' [2013] BTR 607, 607-08.

from shifting debt from low tax jurisdictions to high tax jurisdictions is well documented.[115] The extent to which an MNE uses debt shifting will depend on the extent of the different tax rates and tax benefits in the parent company's jurisdiction and that of its subsidiaries.[116] Debt shifting is also responsive to tax incentives.[117] While low corporate tax rates may influence where an MNE diverts their finance, other factors will also be relevant when MNEs choose between two low-tax Member States. For instance, some MNEs are also able to benefit from dividend exemptions in the Member State of the subsidiary who loaned the money.[118] Dividend exemptions mean that some MNEs will therefore be able to benefit twice due to the lack of corporate tax harmonisation in the EU because different tax systems will characterise the intra-group transaction differently.[119]

Fiance shifting is relatively easy for MNEs. Issuing a loan usually requires the signature of a subsidiary's director. Loans within MNEs are therefore relatively easy because the terms of the loan can be agreed upon easily due to the fact that both the lender and the borrower are owned by the same parent company. Frank Barry and Rosemary Healy-Rae note that many tax authorities demand proof of some genuine activity to allow the subsidiary to benefit from the tax deduction.[120] Nevertheless, some genuine activity is a relatively low threshold to meet and debt shifting is still therefore relatively easy. Furthermore, many of the larger MNEs will design complex structures to maximise the benefits they receive as a result of debt shifting.[121] These complex structures can have high fixed costs.[122] However, for large MNEs, the costs associated with designing and implementing complex debt shifting structures are minimal when compared with the extent to which they can minimise their taxable profits.

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[115] Vijay Jog and Jianmin Tang, 'Tax Reforms, Debt Shifting and Tax Revenues: Multinational Corporations in Canada' (2001) 8(1) Int Tax Public Finance 5, 12.
[116] Raffaele Miniaci, Maria L Parisi and Paolo M Panteghini, 'Debt shifting in Europe' (2014) 21(3) Int Tax Public Finance 397, 398.
[117] Clemens Fuest, Shafik Hebous and Nadine Riedel 'International debt shifting and multinational firms in developing economies' (2011) 113(2) Economics Letters 135, 137.
[118] Alexander Rust, 'BEPS Action 2: 2014 Deliverable - Neutralising the Effects of Hybrid Mismatch Arrangements and its Compatibility with the Non-discrimination Provisions in Tax Treaties and the Treaty on the Functioning of the European Union' [2015] BTR 308, 309.
[119] Svea Holtmann, 'Tax Avoidance Using Hybrid Financial Instruments Among European Countries' [2020] BTR 217, 221.
[120] Barry and Healy-Rae (n 44).
[121] Francis Weyzig, 'The Capital Structure of Large Firms and the Use of Dutch Financing Entities' (2014) 35(2) Fiscal Studies 139, 146.
[122] ibid.

While tax avoidance is an issue, the extent and way in which it constitutes a problem to Member States' can vary. The main concern is that MNEs' tax planning could cause market distortions which occur when the market is not subject to free and fair competition. When MNEs are able to benefit from tax planning they are lowering their costs. Some MNEs will therefore be at a competitive advantage compared to their competitors. These market distortions are a concern because some industries and some corporations are better able to make use of the different profit shifting techniques. For instance, any MNE can engage in profit shifting using either transfer pricing or debt shifting. However, the consensus is that intangible technological products are difficult to value and therefore some MNEs will be able to benefit more than others.[123] Where only some MNEs are able to benefit, distortions can occur and the single market 'cannot function properly' because the single market assumes that market participants are not subject to barriers and unfair competition.[124]

However, the effects of debt shifting are not the same for every Member State and will depend on the tax rate of different Member States. An analysis of the effects of debt shifting worldwide found that for high-tax countries, debt shifting had a negative effect on their corporate tax revenues whereas low-tax countries benefitted from increased tax revenues.[125] Member States who currently have low-tax rates are therefore likely to benefit from debt shifting within the EU. The fact that not every Member State is negatively affected by debt shifting means that harmonisation would not necessarily yield benefits for every Member State.

Nevertheless, market distortions have a negative effect on the single market and therefore affect all Member States. The lack of corporate tax harmonisation means that MNEs are able to use profit shifting techniques to lower their profitable taxes in high-tax Member States. Since the success of these techniques depends on several factors such as the existence of intangible products discussed above, different MNEs benefit to different extents. A harmonised corporate tax system would reduce the opportunity for MNEs to benefit from profit shifting and therefore reduce the market distortions which profit shifting causes.

1.2.4 Summary of the Problems

Some of the problems identified in Chapter One are caused by the behaviour of MNEs themselves such as tax avoidance behaviours. Other problems, such as tax competition, can

[123] Barry and Healy-Rae (n 44) 127.
[124] Veronika Solilová, (n 94); Greaves (n 78) 779.
[125] Harry Huizinga, Luc Laeven and Gaetan Nicodeme, 'Capital structure and international debt shifting' (2008) 88(1) Journal of Financial Economics 80, 96.

be attributed to the behaviour of the Member States. Alternatively, some problems are not attributable to either, such as compliance and administrative costs. All three problems are, however, derived from the lack of corporate tax harmonisation.

Both Member States and MNEs experience the negative effects of the lack of corporate tax harmonisation. The number of different tax systems can act as a barrier to cross border activity for MNEs while Member States find their corporate tax revenues decreasing. The potential benefits for some Member States outlined in the literature are overstated because Member States react to the behaviours of other Member States. A lowering of the corporate tax rate in one Member State triggers other Member States to also lower their corporate tax rates. Therefore, while some Member States will have the lowest corporate tax rate, most other Member States will not have a significantly higher rate. When all locational factors are considered, the actual amount of FDI Member States with the lowest rates are able to attract is greatly reduced.

Corporate tax harmonisation measures would therefore be beneficial to both MNEs and Member States themselves. The costs associated with cross-border trade would reduce, tax avoidance practices would be better identified and tax competition with harmful tax practices would also be more easily identifiable.

1.3 Conclusion and Outlook

In conclusion, this chapter has demonstrated that there are several different problems that arise from each Member State having different tax systems. Equally, it has also been established that there are several different methods that can be used to minimise the differences, and thus, minimise the problems arising from those differences. As stated above, the problems include the costs and burdens for both MNEs and Member States, tax competition between Member States, and tax avoidance by MNEs. The array of problems means that an effective solution must address all aspects of the differences which occur. Likewise, it has also been shown that there are positive and negative harmonisation methods available to address the differences. Each potential method has its own advantages and disadvantages. This means that addressing the differences and the subsequent problems which arise can be done through using multiple methods. This thesis will consider each of the methods and evaluate whether they address the different problems highlighted in this chapter.

There are three main avenues for overcoming or minimising the differences between the different corporate tax systems of the EU. Minimising the differences will also minimise the problems which are derived from the differences. This thesis will consider each in turn.

The first method of minimising the differences between the 27 different corporate tax systems is the four freedoms case law. Chapter Two will evaluate the effect of the case law on the different tax systems of Member States. For corporate tax, both the free movement of capital and establishment are relevant although the latter is most often applied except in situations that involve a third-country aspect because only the free movement of capital can be relied upon in third-country situations.[126] The case law predominantly affects the costs and burdens associated with the coexistence of the different tax systems. The free movement case law protects corporations from discriminatory tax regimes. The case law demonstrates that while the Court recognises the importance of allowing Member States to enact anti-tax avoidance rules, their main purpose is to protect the treaty freedoms. For example, the Court has recognised that the Treaties do not protect 'wholly artificial arrangements' because the Treaties should not protect persons who are abusing the Treaties.[127] However, the Court has also given 'wholly artificial arrangements' and the abuse of Treaties a very narrow interpretation.[128] In practice, this means that corporations are free to use the Treaties to minimise their tax liability. Protections against discrimination reduce MNEs' compliance costs. However, the Court has been more willing to protect the rights of Member States to refuse to offer tax reductions such as loss relief when MNEs are able to claim loss relief in the Member State where the loss occurred.[129] The Courts have therefore attempted to strike a balance between protecting the free movement rights and protecting the rights of Member States to design their own tax systems.

The next method used to minimise the differences between the different tax systems in the EU is Article 107.[130] Article 107 is the EU's State aid control and the effectiveness of using State aid controls to tackle tax issues will be analysed in Chapter Three. Article 107 includes requirements that the contested measure is selective and constitute an advantage. It is, therefore, used by the Commission to tackle tax competition, specifically, harmful tax

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[126] Martha O'Brien, 'Taxation and the third country dimension of free movement of capital in EU law: the ECJ's rulings and unresolved issues' [2008] BTR 628, 631.
[127] C-196/04 *Cadbury Schweppes and Cadbury Schweppes Overseas* [2016] ECR I-07995, para 51.
[128] ibid para 68.
[129] Greg Bousfield, Hans-Jorg Wittmann and Martina Lewen, 'Testing time for tax law' [2005] Euro Law 34, 34.
[130] Consolidated version of the Treaty on the Functioning of the European Union [2008] OJ C115/91.

competition which is preferential in nature. As Chapter Three will explore in more detail, the controls are unable to tackle situations that lead to double non-taxation if the relevant tax regime is not selective.[131] The test for State aid was also not designed to tackle tax regimes and the Commission has had many of their Decisions annulled by the European Courts because they do not meet the requisite legal standard.[132] The analysis of State aid controls is based on the current case law from the General Court alongside the Commission Decisions. However, the Commission has appealed to the European Court of Justice in many instances, claiming that it is the General Court that does not fully understand the EU law.[133] The judgments of the ECJ over the next five years could potentially change the entire effect of State aid controls on tax regimes. Nevertheless, regardless of whether the ECJ introduces significant changes, State aid controls can be used to strike down tax regimes where the requirements under Article 107 are met. While the rigid requirements may mean that some regimes which appear to be harmful are not tackled, Article 107 still acts as a deterrent to dissuade Member States from designing harmful tax measures which clearly meet the requirements. Although it remains possible for Member States to engage in tax competition by designing measures that circumvent the requirements, the existence of Article 107 significantly limits the ability of Member States to implement selective regimes.

The final method which would minimise the differences between the different tax systems and therefore also address the problems is positive tax harmonisation measures. Unlike the previous two measures, positive harmonisation involves creating new laws as opposed to using the Courts or the Commission to apply pre-existing laws. The benefit of positive harmonisation is that it can be used to tackle all three problems since the measure would not be limited by rigid pre-existing requirements. All positive harmonisation measures suffer from the same tension, the more effective the measure is at tackling the problems which arise as a result of the differences between the national tax systems of Member States, the less chance the measure has of being implemented. As this chapter has demonstrated, many Member States benefit from the differences between the national tax system through attracting FDI through harmful tax competition. It is these same Member States which must choose to implement positive harmonisation measures. This means that the only positive

[131] Claire Micheau, 'Tax selectivity in European law of state aid: legal assessment and alternative approaches' (2015) 40(3) EL Rev 323, 324; *McDonalds* (Case SA 38945) Commission Decision 2019/1252 [2018] OJ L 195/20.
[132] T-760/15 *Netherlands v Commission* (General Court 24 September 2019), paras 559-560, 561.
[133] Commission, 'Statement by Executive Vice-President Margrethe Vestager on the Commission's decision to appeal the General Court's judgment on the Apple tax State aid case in Ireland' 25 September 2020 STATEMENT/20/1746.

harmonisation measures which have a realistic chance of implementation are those which either only applies to a select number of Member States, through enhanced cooperation, or are weak in substance and impose few changes on Member States. Equally, the weaker a measure is, the harder it will be to convince Member States that implementing the measure will provide an effective solution to the problems. Chapter Four will analyse the unanimity requirement alongside the principles of EU law which also restrict positive harmonisation measures such as subsidiarity and proportionality. Much of these discussions will take place within the context of the Commission's 2016 proposals for the CCTB and CCCTB.[134] The tension between effectiveness and implementation means that the two proposals are unlikely to be implemented and Chapter Four will therefore briefly consider other positive harmonisation measures.

[134] Commission, 'Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB)' (Proposal) COM(2016) 683 final; Commission, 'Proposal for a Council Directive on a Common Corporate Tax Base' (Proposal) COM(2016) 685 final.

Chapter 2: The Effect of Free Movement Case Law on EU Corporate Taxation

2.1 Introduction

Chapter Two evaluates the effect of free movement case law on EU direct corporate taxation. This chapter will explore how the Court has sought to strike a balance between safeguarding the freedoms and enabling Member States to tackle the problems in Chapter One. Chapter Two begins by exploring the framework of the four freedoms in the EU, before assessing how both establishment and capital has been used in direct taxation. This chapter concludes by providing an overall assessment of the merits of relying on the four freedoms case law as a means of corporate tax harmonisation.

2.2 In Accordance with the Treaties

Member States have sovereignty over corporate tax,[1] and the power to tax is often seen as being 'central to national sovereignty'.[2] While EU treaties were not originally thought to affect tax,[3] the CJEU established in *Avoir Fiscal* that the sovereignty must be exercised in accordance with treaty freedoms.[4] Tax's sensitivities meant that the CJEU's earlier case law is not associated with any strong policy.[5] However, recent direct taxation case law has been especially 'dynamic'.[6] The freedoms have direct effect,[7] meaning they can be relied upon in

[1] Sandra Eden, 'Corporate tax harmonisation in the European Community' [2000] BTR 624, 625-27.
[2] Annette Schrauwen, 'Sources of EU Law for Integration in Taxation' in Dennis Weber (ed), *Traditional and Alternative Routes to European Tax Integration* (IBFD 2010) 15.
[3] Mike Boutell, 'The CJEU's tax tentacles' [2006] Euro Law 11, 12.
[4] Case C-270/83 *Commission of the European Communities v French Republic* [1986] ECR 273; MH Richardson, 'The Hoechst and Pirelli cases: the adventures of an innocent abroad or the curious case of the foreign parents and the missing credit' [1998] BTR 283, 289-90.
[5] Tracy A Kaye, 'Tax Discrimination: A Comparative Analysis of U.S. and EU Approaches' (2005) 7 Fla Tax Rev 47, 101.
[6] Mark Persoff, 'Marks & Spencer: more questions than answers' [2005] BTR 260, 260-67.
[7] Eden (n 1) 626-27.

the national courts.[8] The scopes of capital and establishment are not easily separated.[9] Discrimination on the grounds of residence is prohibited.[10]

The CJEU has consistently found treaty freedom violations.[11] Most cases are preliminary references, where national courts refer a question concerning the interpretation of EU law to the CJEU.[12] Courts of final appeal must use this procedure.[13] National judges then apply the interpretation of EU law to the facts of the case they are presiding over. The CJEU's binding judgements also influence the design of national tax rules.[14] If a Member State did not amend their laws, taxpayers would begin litigation so that they could have their case heard before domestic courts. The domestic Courts would apply the CJEU's rulings due to the direct effect of the four freedoms. The threat of expensive litigation acts as an incentive for Member States to amend their laws. Consequently, corporate tax law has seen increased levels of harmonisation.[15] However, only particular areas concerning very narrow rules have been affected as the CJEU does not recommend or implement new rules. Subsidiarity means the CJEU must only strike down a rule which violates EU freedoms.[16] The CJEU cannot bring an external issue inside the scope of the four freedoms.[17]

This chapter primarily discusses the freedom of establishment and the free movement of capital since corporate taxes are primarily affected by them, not the free movements of goods or services. Both establishment and capital interfere with the ability of Member States to introduce corporate tax rules. Both goods and services can affect corporations but do not interfere with corporate tax rules. The CJEU uses four steps to establish a freedom violation. Firstly, a freedom is identified. Secondly, a restriction of that freedom is identified through

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[8] Case C-26-62 *NV Algemene Transport- en Expeditie Onderneming van Gend & Loos v Netherlands Inland Revenue Administration Reference for a preliminary ruling: Tariefcommissie – Netherlands* [1963] ECR 01.
[9] Harm Schepel, 'Constitutionalising the Market, Marketising the Constitution, and to Tell the Difference: On the Horizontal Application of the Free Movement Provisions in EU Law' (2012) 18(2) European Law Journal 177, 194.
[10] Eden (n 1) 635-36.
[11] Andrew Park, 'A judge's tale: corporation tax and Community law' [2006] BTR 322, 323.
[12] Consolidated version of the Treaty on the Functioning of the European Union (TFEU) [2016] OJ C202/1, art 267.
[13] Andreas Geiger and Thorsten Fischer, 'The clash of EU law and national direct tax laws - example: Germany' (2005) 16(8) ICCLR 328, 328.
[14] Carlo Garbarino, 'Tax transplants and circulation of corporate tax models' [2011] BTR 159, 174-75.
[15] Christiana HJI Panayi, 'Reverse subsidiarity and EU tax law: can Member States be left to their own devices?' [2010] BTR 267, 267.
[16] Carlo Garbarino, 'The development of a judicial anti-abuse principle in Italy' [2009] BTR 186, 190.
[17] Richardson (n 4) 292-96.

comparing objectively comparable situations.[18] Decisions surrounding the comparator determine the discrimination finding.[19] Residents and non-residents are not always objectively comparable.[20] Thirdly, justifications are identified. Finally, if justifications are available, the CJEU will determine whether they are appropriate and proportionate. Corporations exercising their freedoms to lower their tax burden are not, by default, acting abusively.[21] Tax competition's economic benefits are treated equally to other economic benefits by the CJEU.[22]

2.3 Freedom of Establishment

The freedom of establishment allows persons to pursue 'economic activity through a permanent base in another Member State for an indefinite period',[23] and has influenced several tax cases.[24]

2.3.3 Exit Taxes: Correcting the Balanced Allocation of Taxing Powers

2.3.3.1 The Initial Recognition of a Restriction

Exit taxes are taxes levied on unrealised capital gains when a person exits a jurisdiction.[25] Unrealised gains are where the value of assets has increased since last sold. Member States

[18] Frank Barry and Rosemary Healy-Rae, 'FDI implications of recent European Court of Justice decisions on corporation tax matters' (2010) 11(1) EBOR 125, 128-29.
[19] Timothy Lyons, 'Philips Electronics UK Ltd v HMRC: more unjustifiable restrictions on loss relief' [2010] BTR 46, 50-51.
[20] Pedro Cabral and Patricia Cunha, 'The internal market and discriminatory taxation: just how (un)steady is the ground?' (1999) 24(4) EL Rev 396, 400.
[21] Sjoerd Douma and Frank Engelen, 'Halifax Plc v Customs and Excise Commissioners: the CJEU applies the abuse of rights doctrine in VAT cases' [2006] BTR 429, 437-40; Case C-364/01 *The heirs of H Barbier v Inspecteur van de Belastingdienst Particulieren/Ondernemingen buitenland te Heerlen Reference for a preliminary ruling: Gerechtshof 's-Hertogenbosch – Netherlands* [2003] ECR I-15013.
[22] Brady Gordon, 'Tax competition and harmonisation under EU law: economic realities and legal rules' (2014) 39(6) EL Rev 790, 801-05.
[23] Geiger and Fischer (n 13).
[24] Eden (n 1) 635-36.
[25] Gero Burwitz, 'Tax consequences of the migration of companies: a practitioner's perspective' (2006) 7(2) EBOR 589, 592-595.

would not have taxed the actual value and thus suffer indirectly from reduced tax revenues.[26] In comparison, where the person does not exit the Member State, the gains will be taxed upon realisation. Most Member States want to prevent relocations because they believe relocations 'destroy wealth, employment and… taxable items'.[27] The incentive to relocate rests in the differing corporate tax rates of different Member States.[28] Corporations understand they could pay less tax, and exit taxes therefore disincentivise such behaviour.[29]

The CJEU first recognised exit taxes in the context of the individual. In *Lasteyrie*,[30] a person with shares in a French company was taxed on unrealised gains when relocating from France to Belgium. The CJEU held that this breached the freedom of establishment since those relocating would be in a disadvantageous position compared with those staying in France. The option for the suspension of payments could also be restrictive because they were not automatic and required guarantees. Subsequent cases have followed this approach.[31] In response, several Member States, including Germany, amended their rules.[32] While some believed the ruling extended to corporations,[33] others disagreed using both the *Daily Mail*

[26] Darong Dai, 'Is exit tax a good idea for the taxman?' (2018) 45(4) Journal of Economic Studies 810.
[27] Gilbert Parleani, 'Relocation and Taxation: the European Court of Justice Disallows the French Rule of Direct Taxation of Unrealised Gains – Commentary on the ECJ's Decision in Hughes de Lasteyrie du Saillant' (2004) 1(3) European Company and Financial Law Review 379, 381, 384.
[28] Ulrich Schreiber and Gregor Führich, 'European group taxation-the role of exit taxes' (2009) 27(3) European Journal of Law and Economics 257.
[29] ibid.
[30] Case C-9/02 *Hughes de Lasteyrie du Saillant v Ministère de l'Économie, des Finances et de l'Industrie Reference for a preliminary ruling: Conseil d'État – France* [2004] ECR I-02409.
[31] Karen Banks, 'The application of the fundamental freedoms to Member State tax measures: guarding against protectionism or second-guessing national policy choices?' (2008) 33(4) EL Rev 482, 501.
[32] Anno Rainer, Otmar Thoemmes and Eric Tomsett, 'French exit tax incompatible with EC Treaty' (2004) 15(4) International Tax Review 91.
[33] Dieter Endres, 'EU targets Germany's exit tax regime' (2004) 15(5) International Tax Review 4 < https://web-b-ebscohost-com.ezphost.dur.ac.uk/ehost/detail/detail?vid=0&sid=7ddd5de3-fa4b-46e1-b085-908702b1ffab%40pdc-v-sessmgr02&bdata=JnNpdGU9ZWhvc3QtbGl2ZQ%3d%3d#AN=13937715&db=bah> accessed 18th August 2021.

and some *Uberseering* interpretations.[34] In *N*,[35] exit taxes were levied on a shareholder of three Dutch companies relocating to the UK. The CJEU held that requiring guarantees for the suspension of payments prevented individuals from fully enjoying their assets. Fixed cost payment deferrals could also be disadvantageous if the value subsequently decreased. The Commission's 2006 Communication affirmed that the case law applied to corporations.[36] The Communication also discussed payment deferrals, stating that while 'reasonable obligations' to inform Member States when assets were realised were acceptable, such obligations must be necessary and not prevent the freedom of establishment.[37] Likewise, the possibility of 'truly voluntary' immediate taxation was raised.[38]

2.4.2.2 Corporations and Changing Conditions

The CJEU has since considered exit taxes in the context of corporations. The first case to consider this was *National Grid*.[39] A Dutch company was subject to immediate exit taxes when transferring its place of management to the UK. The CJEU found a restriction because companies who have relocated were disadvantaged because immediate taxation resulted in a cash flow disadvantage for those companies.[40] Immediate tax means they are unable to use the proceeds of selling their asset to pay the levy and must use their cash flow.[41] Since companies incorporated in the Netherlands were objectively comparable regardless of their place of management, the disadvantage constituted a restriction.[42] The CJEU held that preserving 'the allocations of powers of taxation' was a legitimate objective.[43] Further, since

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[34] Hans-Jochen Gutike, 'Exit tax planning window opens' (2004) 15(6) International Tax Review 58 < https://web-b-ebscohost-com.ezphost.dur.ac.uk/ehost/detail/detail?vid=0&sid=818e03af-73af-4b4f-ae33-e7d2400eddf2%40pdc-v-sessmgr03&bdata=JnNpdGU9ZWhvc3QtbGl2ZQ%3d%3d#AN=13616002&db=bah> accessed 18th August 2021.

[35] Case C-470/04 *N v Inspecteur van de Belastingdienst Oost/kantoor Almelo* [2006] ECR I-07409.

[36] Commission, 'Exit taxation and the need for co-ordination of Member States' tax policies' (Communication) COM (2006) 825 final, 5.

[37] ibid 6.

[38] ibid 7.

[39] Case C-371/10 *National Grid Indus BV v Inspecteur van de Belastingdienst Rijnmond/kantoor Rotterdam* [2011] ECR I-12273; Thomas Biermeyer, Fabio Elsener and Fiona Timba, 'The Compatibility of Corporate Exit Taxation with European Law' (2012) 9(1) European Company and Financial Law Review 101, 106.

[40] *National Grid* (n 39) para 37.

[41] Burwitz (n 25) 594.

[42] *National Grid* (n 39) para 38.

[43] ibid para 45.

the Netherlands had the right to tax the unrealised gains,[44] the legislation was appropriate for achieving that objective.[45]

There were two principal questions. Firstly, whether exit tax rules must consider subsequent decreases in the asset's value and secondly, whether payment deferrals were necessary. Addressing the former, the immediate calculation was considered proportional.[46] The Netherlands was not obliged to consider subsequent devaluations since the relocation ceased 'all fiscal connection with the company'.[47] Acknowledging the departure from *N*, the CJEU maintained that a company could artificially determine its asset's value using its balance sheets. Addressing the latter, the absence of a deferral was disproportionate.[48] However, bank guarantees were endorsed to mitigate the risks for Member States.[49] The CJEU rejected arguments that deferrals constituted excessive burdens for tax authorities because only tracing of the assets, not of the fluctuations, were necessary.[50] The judgment has created confusion by asserting that requiring annual returns may, where there are many assets, hinder the freedom.[51] The CJEU failed to clarify whether the option of immediate taxation would suffice in such a scenario. As such, neither taxpayers nor Member States can predict how the CJEU will interpret exit tax rules involving complex asset structures. In response to *National Grid*, Italy amended its rules in 2012.[52]

In *Verder*,[53] exit taxes were levied on a German company that transferred their patents to their Dutch permanent establishment. The CJEU found payment over ten yearly instalments restricted the freedom of establishment.[54] Companies transferring assets to other Member States were objectively comparable to those transferring assets within Germany, yet the difference in treatment would discourage the former.[55] The measure was appropriate for preserving the allocation of taxing powers and the risk of Member States not being able to

[44] ibid para 46.
[45] ibid para 48.
[46] ibid para 52.
[47] ibid paras 56 and 58.
[48] ibid para 85.
[49] ibid para 74.
[50] ibid para 76.
[51] ibid para 71.
[52] Giuliano Foglia and Marco Emma, 'Italy: Italian government issues decree implementing exit tax' ITR (31 August 2013) <https://www.internationaltaxreview.com/article/b1fbsqqn3brd3f/italy-italian-government-issues-decree-implementing-exit-tax> accessed 24 August 2021.
[53] Case C-657/13 *Verder LabTec GmbH & Co KG v Finanzamt Hilden* [2015] ECLI-331.
[54] ibid para 39.
[55] ibid paras 37-38.

collect payment deriving from long deferrals satisfied the proportionality requirement.[56] Requiring payment of exit taxes over ten yearly instalments was, therefore, compatible with the freedoms.

2.3.2.3 The Practical Effects of Exit Taxation Case Law

The CJEU has tried to balance respecting the rights of Member States to tax unrealised gains with protecting the freedom of establishment from the disadvantageous effects of exit tax rules. Companies seeking profit maximisation can limit their tax liability, and thus their costs, through relocating to low-tax Member States. Member States want to limit relocations,[57] and exit taxes can be used as a deterrent for this purpose.[58] Hence why certain exit taxes, such as immediate taxes, are banned.[59] The cash-flow disadvantage outweighs the right of Member States to recover tax owed immediately. The case law does not, therefore, allow restrictions on companies moving for the purposes of reduced tax liability. The case law's discrimination-focused analysis will not resolve this issue.[60] The CJEU's refusal to compromise the freedom is unsurprising as they have consistently held that migration is insufficient to qualify as tax evasion.[61] Furthermore, problems can also arise from each Member State having its own exit tax rules.[62]

Common standards have emerged. The CJEU has consistently held that exit taxes may only be engaged when a Member State's right to tax is affected.[63] Where transferred assets remain linked to a parent company in the Member State, exit taxation is not allowed.[64] However, the EU has been criticised due to the lack of guidance.[65] For instance, the CJEU's judgments on tracing assets raised the possibility that certain requirements to update the Member State if the asset has been sold may, where many assets are involved, constitute a restriction. The CJEU has not clarified whether offering immediate taxation would suffice. Additionally, the

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[56] ibid paras 47 and 52.
[57] Parleani (n 27).
[58] Barry and Healy-Rae (n 18) 140.
[59] 'European Commission seeks tax co-ordination' (2007) 41 Euro News 7, 8.
[60] Erik Röder, 'Co-ordination of corporate exit taxation in the internal market and beyond' [2014] BTR 574, 603-04.
[61] Burwitz (n 25) 596-98.
[62] Christophe De Sutter and Thibaut Barras, 'Luxembourg: Luxembourg adopts exit tax rules aligned with ATAD 1' *ITR* (10 July 2019) <https://www.internationaltaxreview.com/article/b1g75cwcfn0515/luxembourg-luxembourg-adopts-exit-tax-rules-aligned-with-atad-1> accessed 24 August 2021.
[63] Thomas Kollruss, 'Third state migration and corporate exit tax: fundamental lack of Member States' legislation?' [2016] BTR 232, 243.
[64] Burwitz (n 25) 593.
[65] Röder (n 60) 578.

restrictions placed on immediate taxation raise the risk that Member States will not recover all tax owed.[66] Therefore, while exit tax case law demonstrates the CJEU's desire to strike a balance, the CJEU has clearly prioritised safeguarding the freedom of establishment.

2.3.3 Cross Border Relief and Deductions: Refining the Removal of Choice

2.3.3.1 The Road to Exhausting Possibilities and the Elimination of Choice

Loss relief and tax deductions are widely available in Member States. In *ICI*,[67] the CJEU considered UK legislation that required subsidiaries to be 'wholly or mainly' in the UK for a parent company to benefit from tax relief.[68] ICI, who owned 49% of a consortium, could not use the losses of a UK-resident wholly-owned subsidiary for tax relief purposes because many of the other subsidiaries were not UK-resident.[69] ICI believed that the breach of the freedom of establishment was undisputable, and the CJEU agreed.[70] The judgment was considered the 'beginning of the end' for Member States' control over taxation.[71] Tax competition increased for the UK after joining the EU and the *ICI* decision made it harder to tackle.[72] Cross-border relief allows MNEs to choose which jurisdictions their profit is taxed in.

The case law was developed in *Marks and Spencer*,[73] where the CJEU 'took an intermediate position' and reconciled the risk of profit shifting with the freedom of establishment by mandating that loss relief need only be available in the absence of alternative loss relief.[74] UK rules prevented resident parent companies from deducting losses suffered by EU subsidiaries but permitted the deduction of UK subsidiary losses.[75] Tax relief constituted an advantage and resident parent companies with resident and EU subsidiaries were objectively

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[66] Barry and Healy-Rae (n 18) 140.
[67] Case C-264/96 *Imperial Chemical Industries plc (ICI) v Kenneth Hall Colmer (Her Majesty's Inspector of Taxes)* [1998] ECR I-04695.
[68] ibid para 23.
[69] ibid paras 3-7.
[70] ibid para 30; Ian Saunders, 'ICI Plc v Colmer (Inspector of Taxes) (Reference to CJEU)' [1996] BTR 465, 466.
[71] Barry and Healy-Rae (n 18) 133-36.
[72] Timothy J Lyons, 'ICI v Colmer affirms Community supremacy' [1999] BTR 65, 68.
[73] Case C-446/03 *Marks & Spencer plc v David Halsey (Her Majesty's Inspector of Taxes)* [2005] ECR I-10837.
[74] Paul Farmer, 'The English Courts and the Application of EU Tax Law' in Daniel Sarmiento and Domingo J Jiménez-Valladolid de L'Hotellerie Fallois (eds) *Litigating EU Tax Law in International, National and Non-EU National Courts* (IBFD 2014) 56.
[75] *Marks & Spencer* (n 73) para 27.

comparable meaning the difference constituted a restriction.[76] The choice of comparator was unsurprising despite tax rules treating foreign subsidiaries and permanent establishments 'almost identically' because the CJEU prefers comparators of the same legal form.[77] Significantly, the CJEU rejected arguments that the lack of tax jurisdiction over non-resident subsidiaries justified preventing loss relief as they believed such an acceptance would render the freedom worthless.[78]

The CJEU considered three justifications.[79] Firstly, the CJEU accepted that cross-border relief could threaten the preservation of taxing power allocations between Member States by allowing MNEs to alter taxable profits.[80] Next, the CJEU acknowledged the risk that without the UK's restrictions, MNEs could use losses twice.[81] Finally, the CJEU acknowledged the measure prevented debt-shifting by preventing MNEs from transferring their losses.[82] The CJEU held that together, the justifications pursued legitimate objectives.[83] However, the measures were not proportional because where all possibilities for tax relief where the losses were incurred are exhausted, and where there is no possibility for future loss relief in respect of those losses, MNEs must have access to cross-border relief.[84]

The ruling demonstrates the tension between preventing the Chapter One problems and safeguarding the freedoms. The broad interpretation of the justifications demonstrates that the problems are recognised by the CJEU.[85] The CJEU understands the damage uncontrolled freedom of establishment would cause to tax regimes.[86] While the absence of the power to tax was insufficient as an independent justification, the notion of symmetrical treatment to losses and profits was relevant.[87] Unfettered cross-border relief would mean Member States would have no choice but to subsidise 'business failures' from across the EU.[88] It has been argued that the ruling allows low-tax Member States to attract more FDI.[89] While this is a

[76] ibid paras 32-34.
[77] Panayi 'Reverse subsidiarity' (n 15) 280.
[78] *Marks & Spencer* (n 73) paras 36-37, 40.
[79] ibid paras 42-43.
[80] ibid paras 45-46.
[81] ibid paras 47-48.
[82] ibid paras 49-50.
[83] ibid para 51.
[84] ibid para 55.
[85] TL [Timothy Lyons], 'Marks & Spencer: something for everyone?' [2006] BTR 9, 11.
[86] Victoria Thompson, 'The CJEU and private clients' [2006] PCB 131, 134.
[87] Marjaana Helminen, 'EU Law Compatibility of BEPS Action 2: Neutralising the Effects of Hybrid Mismatch Arrangements' [2015] BTR 325, 335-36.
[88] John Snape, 'Corporation tax reform - politics and public law' [2007] BTR 374, 398.
[89] Barry and Healy-Rae (n 18) 133-36.

possibility,[90] the concern is overstated due to the removal of choice. This was expected due to the negative effects choice would have on EU corporate tax regimes.[91] The significance is why seven Member States supported the UK.[92]

In *Commission v UK*,[93] the Commission alleged that the UK's legislative response made obtaining relief 'virtually impossible'.[94] The CJEU's dismissal of such complaints demonstrates that the *Marks and Spencer* conditions limit cross-border relief to exceptional circumstances.[95] Although, the conditions remain unclear and domestic litigation has left several questions unanswered.[96] Uncertainty also plagues the future with suggestions that it is highly likely Member States will be 'legally obliged to offer some form of cross-border loss offset'.[97]

2.4.2.2 'No Choice' in Action

Since *Marks and Spencer*, the CJEU has continued to require the absence of choice. In *Oy AA*,[98] the CJEU considered whether Finnish rules, where the eligibility of tax deductions for resident subsidiaries transferring money to parent companies was dependent on the latter's nationality, were compatible with the freedom of establishment.[99] The advantageous deductions with the objective comparability constituted a restriction.[100] The CJEU accepted two *Marks and Spencer* justifications: the allocation of taxing powers and tax avoidance.[101]

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[90] 'European Commission seeks tax co-ordination' (n 59) 8-9.
[91] Greg Bousfield, Hans-Jorg Wittmann and Martina Lewen, 'Testing time for tax law' [2005] Euro Law 34, 34.
[92] Ralph Cunningham and Simon Briault, 'M&S opinion keeps Europe guessing' (2005) 16(5) International Tax Review <https://www.internationaltaxreview.com/article/b1fbv1vy34wrqk/ms-opinion-keeps-europe-guessing> accessed 23 August 2021.
[93] Case C-172/13 *European Commission v United Kingdom of Great Britain and Northern Ireland* [2015] ECLI-50.
[94] ibid para 1.
[95] ibid para 45.
[96] Alison Last, 'Tribunal clarifies cross-border group relief claims' (2009) 20(5) International Tax Review 45 <https://web-b-ebscohost-com.ezphost.dur.ac.uk/ehost/detail/detail?vid=0&sid=5526534f-2368-493e-bbee-d95af7823162%40pdc-v-sessmgr01&bdata=JnNpdGU9ZWhvc3QtbGl2ZQ%3d%3d#AN=42834187&db=bah> accessed 15th April.
[97] Andreas Haufler and Mohammed Mardan, 'Cross-border loss offset can fuel tax competition' (2014) 106 Journal of Economic Behavior and Organization 42, 57.
[98] Case C-231/05 *Oy AA* [2007] ECR I-06373.
[99] ibid paras 17, 28.
[100] ibid paras 32-34, 38, 43.
[101] ibid paras 46, 53-58, 60.

The risk of MNEs using loss relief twice was irrelevant.[102] The rules were also necessary because any deviation would facilitate choices for MNEs.[103] Less restrictive measures were not available.[104] The exhaustive possibilities absence meant some believed it had been relaxed.[105] However, the less restrictive measure requirement meant the essence of exhaustive possibilities was followed.

In *Lidl Belgium,*[106] the CJEU considered the compatibility of a German measure preventing resident companies from accessing loss relief in respect of their non-resident permanent establishment's losses.[107] The CJEU accepted both the allocation of taxing powers and the use of loss relief twice as justifications.[108] The former relied on a double taxation treaty meaning Luxembourg, where the permanent establishment was based, had exclusive taxing rights.[109] The measure was proportional because the permanent establishment had benefitted from Luxembourg's loss relief previously.[110]

In *X Holding,*[111] the eligibility for Dutch resident parent companies forming a single tax entity with their subsidiaries was dependent on the latter's nationality.[112] The difference in treatment between objectively comparable companies constituted a restriction.[113] The measure was necessary to preserve the allocation of taxing powers by preventing the parent company from continually altering its tax entity for tax efficiency.[114] Proportionality requirements were met since subsidiaries of different nationalities were not objectively comparable in the context of the justification.[115] Choice prevention is important to the CJEU[116] and was used in both the proportionality analysis and as a justification.[117]

[102] ibid para 57.
[103] ibid para 64.
[104] ibid para 65.
[105] Panayi 'Reverse subsidiarity' (n 15) 281-88.
[106] Case C-414/06 *Lidl Belgium GmbH & Co KG v Finanzamt Heilbronn* [2008] ECR I-03601.
[107] ibid para 14.
[108] ibid paras 30, 37.
[109] ibid paras 33, 34.
[110] ibid paras 49-51.
[111] Case C-337/08 *X Holding BV v Staatssecretaris van Financiën* [2010] ECR I-01215.
[112] ibid para 15.
[113] ibid para 24.
[114] ibid paras 27, 31, 33.
[115] ibid paras 38, 42.
[116] Panayi 'Reverse subsidiarity' (n 15) 285.
[117] ibid 285.

2.3.2.3 The Significance of Choice Elimination

The CJEU has balanced the risk of profit shifting with the need to allow MNEs to access relief, by only requiring relief to be extended to cross-border scenarios where the MNEs are unable to access relief in the host Member State where the relevant subsidiary or permanent establishment is based, thereby preventing MNEs from relying on the CJEU's jurisprudence to shift their profits from high tax to low tax Member States. Nevertheless, domestic relief must be extended where there is no alternative choice for MNEs, and the CJEU has therefore affected relief regimes across the EU.[118] The process has been described as 'dangerous' for Member States as the CJEU will strike down legislation incompatible with the Treaties.[119] Cross-border relief is reflective of the internal market.[120] However, while the purpose of the treaties was to create 'a cohesive economic union', unfettered relief regimes could be abused by MNEs.[121] Attitudes towards relief vary, with Member States who compete for 'physical investment' opposed to granting such relief because it incentivises corporations to invest in other Member States, whereas Member States who compete for 'mobile' investment will implement such relief because it incentivises profit transferals to parent companies.[122] The CJEU has attempted to balance safeguarding the treaties with solving the Chapter One problems by relying on the 'fiscal principle of territoriality' to distinguish between residents who are taxed on their worldwide income and non-residents.[123] In doing so, the CJEU has recognised 'a symmetry between the limit of the right to tax and the limit of the right to relief'.[124]

2.3.3 Profit Shifting and Wholly Artificial Arrangements

2.3.3.1 Controlled Foreign Corporation Rules

[118] ibid 276-77.
[119] Lyons, 'Philips Electronics' (n 19) 46.
[120] Tim Hackemann, 'Group Taxation in the European Union Unitary vs. Per-Country Approach' in Isabelle Richelle, Wolfgang Schon and Edoardo Traversa (eds), *Allocating Taxing Powers within the European Union* (Springer 2012) 123.
[121] Ruth Mason and Michael S Knoll, 'What is tax discrimination?' (2012) 121(5) Yale L J 1014, 1023-1025.
[122] Zarko Y Kalamov and Marco Runkel, 'On the implications of introducing cross-border loss-offset in the European Union' (2016) 144 Journal of Public Economics 78, 87.
[123] Eden (n 1) 638-41.
[124] ibid 638.

2.3.3.1.1 CFCs as a Tax Avoidance Tool

CFCs are a profit shifting tool and CFC rules exist throughout the EU. MNEs use CFCs to either avoid tax or lower their tax liability.[125] CFC rules, which many Member States have, aim to prevent this method of tax avoidance.[126] UK CFC rules were considered in *Cadbury Schweppes*,[127] where the CJEU effectively permitted CFCs except where there were 'wholly artificial arrangements'. A company constituted a CFC upon satisfying three conditions.[128] The company had to be resident outside of the UK, controlled by a person who was resident in the UK and must have been subject to a lower tax burden in the foreign jurisdiction.[129] While companies who met the conditions outlined above would have their profits apportioned, there were several exceptions.[130] One exception was a motive test where the company could demonstrate that the purpose of the transactions and of the CFC was not to lower their tax burden.[131]

The Cadbury Schweppes Group included a UK resident parent company and two Irish resident subsidiaries both considered CFCs.[132] The CJEU found a restriction since parent companies were treated differently depending on their subsidiaries' nationality.[133] The argument that the rules equalised treatment was rejected as the parent company were 'taxed on the profits of another legal person',[134] which could deter the exercise of the freedom.[135] The justifications centred on tackling tax avoidance.[136] Favourable tax treatment could not be offset through domestic measures and reductions in tax revenues could not justify restrictions.[137] The freedom allows economic participation in other Member States and such

[125] Blazej Kuzniacki, 'Tax avoidance through controlled foreign companies under European Union law with specific reference to Poland' (2017) 7(1) Accounting, Economics, and Law: A Convivium 7 <https://www.degruyter.com/document/doi/10.1515/ael-2015-0018/html> accessed 24 August 2021; Jonathan Cooklin, 'Corporate exodus: when Irish eyes are smiling' [2008] BTR 613, 613-14.
[126] Frans J Vanistendael, 'Company taxation, state aid and fundamental freedoms: is the next step enhanced cooperation?' (2005) 30(2) EL Rev 209, 216.
[127] Case C-196/04 *Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue* [2006] ECR I-07995.
[128] Income and Corporation Taxes Act (ICTA) 1988, ss 747-756.
[129] ibid ss 747 (1)(a)-(c).
[130] ibid ss 752; *Cadbury Schweppes* (n 127) para 8.
[131] *Cadbury Schweppes* (n 127) paras 9-11.
[132] ibid para 39.
[133] ibid paras 43, 46.
[134] ibid para 45.
[135] Vikram Chand and Benjamin Malek, 'The relevant economic activity test and its impact on the international corporate tax policy framework' [2019] BTR 394, 407-08.
[136] *Cadbury Schweppes* (n 127) para 48.
[137] ibid para 49.

participation does not presuppose tax evasion.[138] Further, the right for MNEs to benefit from advantageous treatment was already confirmed in *Centros* which led some to argue *Cadbury Schweppes* had already been answered, including the Advocate General.[139] However, this view was not universal, with some believing the UK's CFC rules were compatible.[140]

The CJEU held that companies could exercise the freedom to benefit from reduced tax liability but measures could restrict 'wholly artificial arrangements' since the freedom 'presupposes actual establishment' and 'the pursuit of genuine economic activity'.[141] Wholly artificial arrangements threaten the allocation of taxing powers by giving MNEs a choice over where their profits are taxed.[142] The rules were appropriate for tackling tax avoidance but not proportional because no exceptions applied to the Cadbury Schweppes Group.[143] Exceptions had to be available for non-wholly artificial arrangements and nearly all CFCs were protected by the freedom.[144] Wholly artificial arrangements are restricted to scenarios where the resident company establishes a CFC with only a 'letterbox' or 'front'.[145] The CJEU endorsed the Advocate General's opinion that a CFC's activities being a wholly artificial arrangement is not presupposed even where the CFC's activities could have been carried out in the home Member State.[146] Therefore, only measures tackling wholly artificial arrangements are proportional.[147]

2.3.3.1.2 Wholly Artificial Arrangements and The Effective Sanctioning of All CFCs

By requiring arrangements to be 'wholly' artificial, the CJEU effectively sanctions all CFCs. The freedom's purpose was to offer choice over where to conduct business activities.[148] The disdain some Member States have towards the freedom cannot be prioritised over the treaty

[138] ibid paras 50, 53.
[139] Peter Cussons, 'Member States ignore European tax decisions' [2004/05] Euro Law 14, 14; TL [Timothy Lyons], 'What will the CJEU decide tomorrow?' [2006] BTR 399, 405-06; Barry and Healy-Rae (n 18) 131-32; Philip Simpson, 'Cadbury Schweppes Plc v Commissioners of Inland Revenue: the CJEU sets strict test for CFC legislation' [2006] BTR 677, 678-79.
[140] Bousfield, Wittmann and Lewen (n 91) 36.
[141] *Cadbury Schweppes* (n 127) paras 51, 54.
[142] ibid para 56.
[143] ibid paras 59, 61-63.
[144] ibid paras 65-66; Kollruss (n 63) 239-40.
[145] *Cadbury Schweppes* (n 127) para 68.
[146] ibid para 69.
[147] ibid paras 73-75.
[148] Martha O'Brien, 'Taxation and the third country dimension of free movement of capital in EU law: the CJEU's rulings and unresolved issues' [2008] BTR 628, 664.

rights.[149] Critics argue that treaty abuses are not distinguished from legitimate relocations away from particular tax regimes.[150] Requiring the arrangements to be 'wholly' artificial means that the CJEU is only interested in preventing situations 'where there is a high level of abuse'.[151] The scope of 'economic activity' is uncertain, 'internal management' costs are likely insufficient and 'something external' will likely be required.[152] The ruling made low-tax jurisdictions more of an attractive place to invest or relocate to.[153] The significance on several tax regimes was immediately recognised, including those of Germany and Sweden, who were just some of the Member States commentators suspected would need to change their rules.[154] The rulings left 'little room for the application of CFC rules' in the EU.[155] However, many Member States use amended CFC rules which have exceptions for EU CFCs including Germany.[156] There have been 'increasing investments in low-tax EU countries by German multinationals'.[157] The UK also continues to use CFC rules.[158] This continued use demonstrates the importance Member States place on CFC rules.

2.3.3.2 Other Profit Shifting Rules

2.3.3.2.1 The Development of the Thin Cap Framework

Other profit shifting rules limit thin capitalisation and transfer (mis)pricing. A 'transfer price' is the 'price set by a taxpayer when selling to, buying from, or sharing resources with

[149] Lyons (n 139).
[150] Joachim Englisch, 'BEPS Action 1: Digital Economy - EU Law Implications' [2015] BTR 280, 293-96.
[151] Simon Whitehead, 'CFC Legislation and Abuse of Law in the Community' in Dennis Weber (ed), *The Influence of European Law on Direct Taxation* (Kluwer Law International 2007) 8.
[152] Simpson (n 139) 682.
[153] Barry and Healy-Rae (n 18) 131-32.
[154] Claire Jones, 'UK rule change likely after EU court's Cadbury Schweppes verdict' (2006) 17(9) International Tax Review 6.
[155] Peter Koerver Schmidt, 'Taxation of Controlled Foreign Companies in Context of the OECD/G20 Project on Base Erosion and Profit Shifting as well as the EU Proposal for the Anti-Tax Avoidance Directive – An Interim Nordic Assessment' [2016] Nordic Tax Journal 87, 101.
[156] Till Moser and Sven Hentschel, 'Implications of different Brexit scenarios from a German tax perspective' [2016] BTR 393, 397.
[157] Rainer Brautigam, Christoph Spengel and Frank Streif, 'Decline of Controlled Foreign Company Rules and Rise of Intellectual Property Boxes: How the European Court of Justice Affects Tax Competition and Economic Distortions in Europe' (2017) 38(4) Fiscal Studies 719.
[158] Taxation (International and Other Provisions) Act 2010 'TIOPA 2010', part 9A.

a related (associated) person'.[159] Transfer pricing rules aim to prevent profit shifting by requiring that transactions between related companies happen on economic terms.[160] Thin capitalisation rules tackle the problem of finance shifting by preventing 'the arbitrary transfer of the tax debt' between Member States.[161] Debt financing enables a corporation to alter its tax base in different Member States.[162] A corporation is thinly capitalised 'whenever its proportion of debt capital in relation to its equity capital is high'.[163] Both theory and empirical evidence consider taxes to be an 'important' factor 'in determining the capital structure of companies'.[164] Companies become thinly capitalised in high-tax Member States to lower their tax burdens.[165]

In *Lankhorst-Hohorst*,[166] German tax authorities interpreted a loan made by a Dutch subsidiary to their German parent as a 'covert distribution of profits' since identical terms would not be granted by a third-party.[167] The finding of a restriction was criticised for necessitating an understanding of other Member States' rules.[168] Tackling tax evasion was dismissed because although exceptions were made where loans were granted on economic terms,[169] the rules were unspecific and no abuse by Lankhorst-Hohorst was found.[170] Coherence of tax systems and effectiveness of fiscal supervision were also dismissed as they lacked direct links and clear arguments.[171] The finding of a violation is widely believed to apply to all transfer pricing rules.[172] Both the UK and Denmark supported Germany due to the ruling's significance.[173]

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[159] Veronika Solilová, 'Transfer pricing rules in EU member states' (2010) 58(3) Acta Univ Agric et Silvic Mendelianae Brun 243, 249.
[160] Barry and Healy-Rae (n 18) 138.
[161] ibid 137.
[162] Christiana HJI Panayi, *European Union Corporate Tax Law* (CUP 2013) 350.
[163] Marc Morris, 'United in diversity, divided by sovereignty: hybrid financing, thin capitalization, and tax coordination in the European Union' (2014) 31(3) Arizona Journal of International and Comparative Law 761, 786.
[164] Michael Overesch and Georg Wamser, 'Corporate tax planning and thin-capitalization rules: evidence from a quasi-experiment' (2010) 42(5) Applied Economics 563.
[165] Clemens Fuest, Shafik Hebous, and Nadine Riedel, 'International Profit Shifting and Multinational Firms in Developing Countries' in Clemens Fuest and George R Zodrow (eds), *Critical Issues in Taxation and Development* (The MIT Press 2013) 145.
[166] Case C-324/00 *Lankhorst-Hohorst GmbH v Finanzamt Steinfurt* [2002] ECR I-11779.
[167] ibid paras 11-12.
[168] ibid para 32; Banks (n 31) 489-90.
[169] *Lankhorst-Hohorst* (n 166) paras 34-35.
[170] ibid paras 37-38.
[171] ibid paras 39, 42-44.
[172] ibid para 45; Cussons (n 139).
[173] Gareth Green and Jonathan Levy, 'The end of thin-capitalization rules as we know them: thin-capitalization rules, arguably, no longer apply within the EU' (2002) 14(1) International

In *Thin Cap*,[174] the UK's thin capitalisation rules constituted a freedom restriction.[175] Both the justifications of tax system's cohesion and ensuring dividend payments were only taxed once were rejected due to the absence of direct links.[176] Tackling abusive practices was accepted due to the specificity of its design, the inclusion of the 'internationally-recognised' arm's length principle which was applied flexibly, and the acceptance that such practices threaten the allocation of taxing powers.[177] The CJEU endorsed the Advocate General's Opinion that legislation based on 'objective and verifiable elements' aiming to identify wholly artificial arrangements is proportional under two conditions.[178] Firstly, taxpayers must have the right to respond and secondly, it must not result in a higher tax burden than would have occurred under the arm's length principle.[179] Pre-1995 rules were not proportional and post-1995 and -1998 rules were left to the domestic courts to consider.[180] Finally, the CJEU also confirmed that the obligation for a Member State to avoid double-taxation only arises where non-resident companies are taxed on resident subsidiaries' income.[181]

2.3.3.2.2 The Practical Application of the Thin Cap Framework

The CJEU has continued to rely on the Thin Cap framework to mediate the tensions which exist between the freedoms and Chapter One problems. In *Masco Denmark*,[182] the CJEU considered Danish rules that stipulated interest received by a Danish parent company in respect of a loan to their German subsidiary was ineligible for tax deductions when the same interest would be tax deductible if their subsidiary was Danish.[183] The freedom was restricted since neither subsidiary received tax deductions, and resident companies are

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Tax Review 24 < https://web-a-ebscohost-com.ezphost.dur.ac.uk/ehost/detail/detail?vid=0&sid=6c5ace1d-9f50-418e-aa82-cc37f791ed43%40sdc-v-sessmgr03&bdata=JnNpdGU9ZWhvc3QtbGl2ZQ%3d%3d#AN=9059848&db=bah> accessed 19th August 2021.

[174] Case C-524/04 *Test Claimants in the Thin Cap Group Litigation v Commissioners of Inland Revenue* [2007] ECR I-02107.

[175] ibid paras 35, 63.

[176] ibid paras 65-66, 68, 70.

[177] ibid paras 70-71, 75-77.

[178] ibid para 82.

[179] ibid paras 82-83.

[180] ibid paras 84, 87.

[181] ibid paras 88, 90.

[182] Case C-593/14 *Masco Denmark ApS and Damixa ApS v Skatteministeriet* [2016] ECLI-984.

[183] ibid para 16.

objectively comparable irrespective of their interests' origins.[184] The measure did not appropriately prevent tax avoidance as its scope exceeded wholly artificial arrangements.[185] Although it did appropriately protect taxing powers, it was disproportionate because it extended to non-resident subsidiaries with no access to deductions.[186]

In *SGI*,[187] the CJEU considered Belgian rules which taxed 'unusual or gratuitous advantages' from resident companies to interdependent non-resident companies only.[188] The freedom was restricted since the recipient's residency was a material factor.[189] The measure was appropriate for protecting the allocation of taxing powers and preventing tax avoidance because it prevented MNEs from choosing where their profits are taxed.[190] The CJEU held that the *Thin Cap* proportionality test was met.[191]

Hornbach-Baumarkt[192] considered national rules requiring companies' income to be assessed as though advantages granted by interdependent non-resident companies were calculated on commercial terms when the same advantages were not calculated on commercial terms when granted by resident companies.[193] The freedom was restricted since residency was a material factor.[194] The measure appropriately protected the allocation of taxing powers by eliminating choice.[195] The *Thin Cap* assessment was left to the domestic court.[196] However, the CJEU clarified that companies can demonstrate that advantages are based on commercial reasoning even where such reasoning is derived from being a shareholder.[197]

Impresa Pizzarotti,[198] concerned Romanian rules mandating transfer pricing for transfers from resident branches to non-resident parent companies only.[199] The freedom was restricted

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[184] ibid paras 22, 26-27, 31.
[185] ibid paras 44-45.
[186] ibid paras 34, 38-39, 43.
[187] Case C-311/08 *Société de Gestion Industrielle (SGI) v Belgian State* [2010] ECR I-00487.
[188] ibid paras 19, 37.
[189] ibid paras 42-45, 55.
[190] ibid paras 60, 63-66, 69.
[191] ibid paras 71-72, 75.
[192] Case C-382/16 *Hornbach-Baumarkt-AG v Finanzamt Landau* [2018] ECLI-366.
[193] ibid paras 27, 31.
[194] ibid paras 33-35.
[195] ibid paras 41, 46-47.
[196] ibid para 57.
[197] ibid para 58.
[198] Case C-558/19 *Impresa Pizzarotti & C SpA Italia Sucursala Cluj v Agenţia Naţională de Administrare Fiscală - Direcţia Generală de Administrare a Marilor Contribuabili* [2020] ECLI-806.
[199] ibid paras 15, 20.

as the companies' residencies were material factors.[200] The measure appropriately maintained the allocation of taxing powers and the *Thin Cap* proportionality test was left to the domestic courts.[201]

2.3.4 Freedom of Establishment Conclusion

The freedom of establishment is a useful tool, alongside the free movement of capital which will be discussed in the next section, to tackle the differences which occur between tax systems in the EU. Through minimising the differences, the Chapter One problems are equally minimised. However, the freedom of establishment does not resolve all problems and has in some situations prioritised the rights of MNEs to lower their tax burdens. The freedoms case law also suffers from several difficulties which the concluding section of this chapter will discuss.

2.4 Free Movement of Capital

While the case law initially 'developed more slowly',[202] this section will demonstrate how the free movement of capital has increasingly provided a foundation for challenging direct tax measures.[203] This section firstly analyses cases concerning third countries. Then analyses intra-EU restrictions and discriminations cases. Discriminatory requirements which differentiate on the basis of a corporation's seat has the same effect as one which does so on the basis of nationality.[204] Directive 88/361 defines 'capital',[205] although it is 'not exhaustive'.[206] 'Capital' is considered to be a 'one-sided transfer of value in kind or cash'.[207] ECJ decisions which support taxpayers' rights to equal tax on dividends are increasingly common.[208] Central to determining whether freedoms are violated, the CJEU assesses

[200] ibid para 26.
[201] ibid paras 31, 33-34, 38.
[202] Jukka Snell, 'Free Movement of Capital: Evolution as a Non-Linear Process' in Paul Craig and Gráinne de Búrca (eds), *The Evolution of EU Law* (OUP 2021) 601.
[203] Vanistendael, 'Company taxation' (n 126) 213.
[204] 'Practical justice instead of academic controversy - the Hoechst decision' [2001] BTR 273, 277.
[205] Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty [1988] OJ L 178/5.
[206] Graeme Baber, 'Free movement of capital: liberalisation or harmonisation?' (2012) 33(7) Comp Law 214, 214-15.
[207] Geiger and Fischer (n 13) 329.
[208] Boutell (n 3).

whether the taxpayer is in a 'worse economic position taking into account his domestic position'.[209]

2.4.1 Treaty Freedoms Beyond the EU

Unlike the other freedoms, capital freedoms extend to third countries,[210] primarily to support 'the euro as an international reserve currency'.[211] It 'expresses economic openness towards the whole world'.[212] However, these cases are analysed separately because the CJEU is more willing to accept justifications when the free movement of capital in respect of third countries is violated.[213]

In *Itelcar*,[214] the CJEU considered Portuguese rules which determined that excessive interest on a loan from a non-EU resident company to a connected resident company was ineligible for tax deductions when the same interest would be eligible if the lender was a Portuguese resident. Due to the third-country dimension, free movement of capital was considered and a restriction was found since residency was a material factor.[215] The measure appropriately tackled thin capitalisation, a form of tax avoidance.[216] The taxpayer had the right to respond and tax deductibility was prevented only to the extent the loan was considered excessive.[217] However, the measure was not proportional because its legal scope extended to unrelated companies whose 'economic reality… cannot be disputed' despite the measure only being enforced where companies were related.[218] Further, the lack of legal certainty contributed to the rules not being proportional.[219] *Itelcar* demonstrates that the *Thin Cap* conditions are applicable to the free movement of capital cases.[220]

In *S v A*,[221] the CJEU considered a Swedish measure which exempted dividends, distributed in the form of shares in a subsidiary, from income tax only if either the distributor was

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[209] ibid.
[210] Geiger and Fischer (n 13) 329.
[211] O'Brien (n 148) 631.
[212] Richard Lyal, 'Free Movement of Capital and Non-Member Countries – Consequences for Direct Taxation' in Dennis Weber (ed), *The Influence of European Law on Direct Taxation* (Kluwer International Law 2007) 17.
[213] Lyons (n 139) 402-03.
[214] Case C-282/12 *Itelcar — Automóveis de Aluguer Lda v Fazenda Pública* [2013] ECLI-629.
[215] ibid paras 13, 16, 25, 28, 29, 31.
[216] ibid paras 33, 35.
[217] ibid para 39.
[218] ibid paras 41-43.
[219] ibid para 44.
[220] ibid paras 37-38.
[221] Case C-101/05 *Skatteverket v A* [2007] ECR I-11531.

established in the EEA or in a country which had concluded with Sweden a convention providing for the exchange of information.[222] The contested measure was considered to constitute a restriction on the free movement of capital between Member States and third countries.[223] The CJEU considered whether the contested measure was justified 'by the need to guarantee the effectiveness of fiscal supervision'.[224] The CJEU noted that the measure must be proportional for this justification to be relied on.[225] The question of proportionality was left to the Swedish courts to determine.[226]

In *EV*,[227] the CJEU considered whether Germany's treatment of profits distributed by a non-EU subsidiary to a resident subsidiary in comparison to the treatment of profits distributed by resident subsidiaries contravened the free movement of capital.[228] The difference in treatment, namely harsher conditions, constituted a restriction.[229] The CJEU considered whether the situations were objectively comparable, and found that they were.[230] The CJEU considered whether there was an overriding reason in the public interest, namely tackling abusive tax arrangements.[231] This was rejected since the measure was imprecise and did not specifically target wholly artificial arrangements.[232] Finally, the measure also contained an 'irrebuttable presumption of abuse'.[233]

These cases demonstrate that the free movement of capital applies to third-country scenarios and despite the CJEU's willingness to accept justifications more easily, the CJEU has also readily found measures to be in violation of the freedom.

2.4.2 The (Very) Narrow Existence of Non-Discriminatory Restrictions

As both this section and the following section demonstrates, the free movement of capital is still most frequently used to tackle measures that restrict the free movement of capital between Member States. Increasingly, the CJEU has moved towards discussions of

[222] ibid para 18.
[223] ibid para 43.
[224] ibid paras 53-54.
[225] ibid para 56.
[226] ibid para 65.
[227] Case C-685/16 *EV v Finanzamt Lippstadt* [2018] ECLI-743.
[228] ibid paras 30-33, 42.
[229] ibid para 64.
[230] ibid para 93.
[231] ibid para 94.
[232] ibid paras 95-99.
[233] ibid para 98.

restrictions for the freedom of establishment.[234] Restrictions refer to situations where corporate tax measures 'prohibit, impede or render less attractive the exercise of the basic freedoms'.[235] However, the free movement of capital was not originally given the same level of importance as the other freedoms and only gained direct effect in the Treaty of Maastricht.[236] This is why the CJEU is less willing to adopt a restrictions-based approach seen in the case law of other freedoms.

As this chapter previously outlined, there are four separate freedoms in the EU. The CJEU has developed the principle of mutual recognition to regulate the free movement of goods.[237] However, Stephen Weatherill argues that the principle is better understood as 'a principle of conditional or non-absolute mutual recognition'.[238] This qualifier is certainly true since the principle developed by the CJEU, and later reaffirmed in Regulation (EU) 2019/515 does ensure legally marketable goods in one Member State can be legally marketed in other Member States by preventing technical barriers concerning the legal definition of categories of goods from barring EU goods to be marketed in particular ways.[239] However, it does so with key limitations. Member States remain able to 'show justification for trade-restrictive practices …'.[240] For example, the regulation explicitly provides for the 'temporary suspension of market access' for situations where there are 'serious' human or environmental risks, or where the goods are prohibited due to 'public morality or public security'.[241] The principle does not, therefore, place an unfettered duty on Member States to always recognise the classification of goods. As this chapter has demonstrated, mutual recognition is not applied to corporate taxation, where differences in different definitions between Member States could hinder the free movement of capital, for example by imposing

[234] Case C-250/95 *Futura Participations SA and Singer v Administration des contributions* [1997] ECR I-02471; Banks (n 31) 482-83.
[235] Helminen (n 87) 327-28; Case C-442/02 *CaixaBank France v Ministère de l'Économie, des Finances et de l'Industrie* [2004] ECR 1-08961, para 11.
[236] Sabine Frerichs, 'Unravelling the European Community of Debt' (2016) 22(6) European Law Journal 720, 726-727.
[237] Case 120/78 *Rewe-Zentral AG v Bundesmonopolverwaltung für Branntwein* ('Cassis de Dijon') [1979] ECR 649.
[238] Stephen Weatherill, 'The principle of mutual recognition: it doesn't work because it doesn't exist' (2018) 43(2) EL Rev 224, 225-26.
[239] Council Regulation 2019/515 of the European Parliament and of the Council of 19 March 2019 on the mutual recognition of goods lawfully marketed in another Member State and repealing Regulation (EC) No 764/2008 [2019] OJ L91/1.
[240] Weatherill (n 238).
[241] European Commission, 'Guidance document for the application of Regulation (EU) 2019/515 of the European Parliament and of the Council of 19 March 2019 on the mutual recognition of goods lawfully marketed in another Member State and repealing Regulation (EC) No 764/2008' (European Commission, 5th March 2021) <https://ec.europa.eu/docsroom/documents/45593 > accessed 7 September 2021.

double taxation. The principle of mutual recognition in the context of goods is not analogous to its application in corporate tax situations for two primary reasons. Firstly, the principle contains several qualifiers such as not being applicable to situations involving public morality, which allows it to take account of more sensitive areas. Corporate tax has always been politically sensitive and it would therefore be inappropriate for the CJEU to impose a similar duty to corporate tax situations. Secondly, the effect of the Member State which recognises the classification or definition of another Member State is substantially lesser in the context of goods than it is with corporate taxes. A Member State allowing intra-EU goods to market themselves as a certain type of alcohol or food does not suffer any monetary detriment. Recognising other tax systems' definitions does lead to reduced tax revenues. These reasons are why the non-discriminatory restrictions of capital tax cases where a breach has been found are limited to *Caster*. The CJEU recognises that the implication of extending principles such as mutual recognition would have far greater consequences in corporate tax measure cases.

2.4.2.1 The Independent Exercise of Separate Fiscal Sovereignty

Member States' retention of tax sovereignty means that both source states and residence states can legitimately tax the same profit.[242] This may create restrictive effects even where neither state exercises such sovereignty discriminatorily. The CJEU has considered whether the free movement of capital extends to such scenarios.

In *SGA*,[243] the CJEU considered French rules which sought to offset the double taxation of dividends received by French companies subject to French corporate tax which was also subject to a levy in another Member State, by granting tax credits limited to the amount France would receive if the dividends alone were subject to French corporation tax and without fully offsetting the tax levied by the other Member State.[244] The CJEU noted that where double taxation arises, the Member State of origin is under no obligation to prevent or rectify the disadvantages.[245] Where the measure is not discriminatory, disadvantages that arise from two Member States exercising their tax jurisdictions do not constitute restrictions.[246] Therefore, there was no restriction, and thus no violation, of the free movement of capital.

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[242] Mason and Knoll (n 121) 1027.
[243] Case C-403/19 *Société Générale SA (SGA) v Ministre de l'Action and des Comptes Publics* [2021] ECLI-136.
[244] ibid para 25.
[245] ibid para 29.
[246] ibid para 40.

In *Kerckhaert*,[247] the CJEU considered Belgian income tax legislation which applied a uniform tax rate to dividends distributed by both residents and non-residents without offering any mechanism to avoid double taxation in respect of the latter.[248] Belgian rules do not differentiate on the basis of residency and the rulings in previous cases such as *Lenz* or *Manninen*, which concerned legislation that differentiated on the basis of residency, were not applicable.[249] Belgian shareholders are not objectively different depending on the origin of their dividends and uniform treatment is not discriminatory.[250] The double taxation of dividends distributed by non-residents is caused by 'the exercise in parallel by two Member States of their fiscal sovereignty'.[251] Therefore, both resident and non-resident dividends can be treated uniformly by Member States, who are not responsible for the disadvantages caused by two sovereign states each exercising their tax jurisdictions.[252] However, the 'distinction' between this case and the preceding case law is not universally supported as previous cases required Member States to 'recognize the tax system of another Member State' despite this being 'emphatically' rejected in *Kerckhaert*.[253] Nevertheless, the CJEU has continued to support this rationale, and the case is indicative of the CJEU's aversion to embracing a restrictions-based approach for the free movement of capital.[254]

2.4.2.2 The (limited) Recognition of Non-Discriminatory Restrictions

In *Caster*,[255] the CJEU found that German tax rules which applied a flat tax rate on a taxpayer's income from a non-resident investment fund where that fund had not communicated and published particular information mandated in legislation which applied to both resident and non-resident funds without distinction, constituted a restriction on the free movement of capital.[256] The allocation of taxing powers was rejected since the measure did not seek to prevent conduct that could interfere with the allocation.[257] Effective fiscal

[247] Case C-513/04 *Mark Kerckhaert and Bernadette Morres v Belgian State* [2006] ECR I-10967.
[248] ibid para 14.
[249] ibid paras 16-17.
[250] ibid paras 18-19.
[251] ibid para 20.
[252] ibid para 24.
[253] Snell (n 202) 594.
[254] Jukka Snell and Jussi Jaakkola, 'Economic Mobility and Fiscal Federalism: Taxation and European Responses in a Changing Constitutional Context' (2016) 22(6) European Law Journal 772, 780.
[255] Case C-326/12 *Rita van Caster and Patrick van Caster v Finanzamt Essen-Süd* [2014] ECLI-2269.
[256] ibid paras 24, 38.
[257] ibid paras 40, 43-44.

supervision and tax collection were rejected because the measure went beyond what was necessary as individual taxpayers could have provided the information, and the subsequent increased administrative burdens could not justify the restrictions.[258] Therefore, the measure could not be justified.[259]

Despite this restrictions-based approach, the CJEU continues to primarily find four freedoms violations only in situations where discrimination, overt or covert, has arisen.[260] Additionally, the restrictions-based approach remains more limited for the free movement of capital in comparison to other freedoms. Within direct taxation cases, the restriction-based approach remains primarily restricted to the language of the CJEU while the practical analysis remains focused on discrimination.[261]

2.4.3 The Wide Applicability of Intra-EU Discriminatory Measures

2.4.3.1 Objective Incomparability – Exempting the Equal Treatment Duty

If a measure has a restrictive effect but the situations are not objectively comparable, the freedom is not violated. These cases demonstrate that failure to find objective comparability is rare.

In *D*,[262] the CJEU considered whether legislation which allowed resident taxpayers tax deductions for their wealth tax but did not offer such benefits to non-resident taxpayers when their assets were predominantly in the latter's state of residence was compatible with the free movement of capital.[263] The CJEU's default position is that for direct taxes, residents and non-residents are not comparable.[264] For income taxes, they are not comparable to the extent the non-resident has most of their income predominantly in their state of residence.[265] Tax benefits granted to residents do not, therefore, need to be extended to non-residents if they are not objectively comparable.[266] This position changes where the

[258] ibid paras 45, 49-50, 56.
[259] ibid para 57.
[260] Jukka Snell, 'Non-discriminatory tax obstacles in Community law' (2007) 56(2) ICLQ 339, 349-55.
[261] ibid 349.
[262] Case C-376/03 *D v Inspecteur van de Belastingdienst/Particulieren/Ondernemingen buitenland te Heerlen* [2005] ECR I-05821.
[263] ibid para 19.
[264] ibid para 26.
[265] ibid para 27.
[266] ibid para 28.

non-resident taxpayer holds 'no significant' income in their resident state.[267] The measure was not a restriction as residents and non-residents with a small amount of wealth in the state were not objectively comparable.[268] While this case concerns individuals, it provides useful context and insight into how the CJEU approaches capital cases and direct taxation.

In *Pensioenfonds*,[269] the CJEU found that Swedish legislation which taxed dividends distributed by resident companies differently depending on whether they were received by non-resident companies, in which case the tax was levied at source, or resident pension funds, where the tax was calculated as a definitive lump sum and on a notional yield, did not violate the free movement of capital.[270] Objective comparability was considered in the context 'of the objective, purpose and content' of the contested measure.[271] Resident and non-resident companies were not comparable.[272] The aim of tax neutrality assumes all assets are taxed, that pension funds are taxed annually and that the taxpayer's capital is taxed, but none of these could be achieved in respect of non-resident pension funds.[273]

These cases show that the CJEU does not require Member States to treat objectively different taxpayers equally.

2.4.3.2 Other Justifications – The Final Circumvention of Treaty Obligations

Once situations are deemed objectively comparable, the CJEU will consider whether the measure can be justified on other grounds. Many justifications are rejected, and those which are accepted are interpreted narrowly.[274]

In *Lenz*,[275] the CJEU found an Austrian measure which offered taxpayers in receipt of dividends distributed by Austrian companies choice over tax methods, while subjecting such dividends from non-residents to ordinary taxation, both a restriction and violation of the free movement of capital.[276] Objective comparability was found since double taxation, which the measure sought to eliminate, was a risk for residents and non-resident companies alike.[277] The tax system's cohesion was rejected because the measure did not require specific historic

[267] ibid para 29.
[268] ibid para 43.
[269] Case C-252/14 *Pensioenfonds Metaal en Techniek v Skatteverket* [2016] ECLI-402.
[270] ibid paras 26, 66.
[271] ibid para 51.
[272] ibid para 63.
[273] ibid paras 58-62.
[274] Vanistendael, 'Company taxation' (n 126) 214.
[275] Case C-315/02 *Anneliese Lenz and Finanzlandesdirektion für Tirol* [2004] ECR I-07063.
[276] ibid paras 16-17, 21-22.
[277] ibid paras 28, 30-31, 33.

tax treatment for resident companies to benefit, and an extension to non-residents would not prevent the elimination of double taxation.[278] Finally, fiscal supervision was rejected since the differentiation did not aid supervision and other measures, while administratively harder, were available.[279] Member States can refuse tax benefits for fiscal supervision purposes only where there is insufficient information,[280] but in *Lenz* they could access the information through administrative efforts.

In *Manninen*,[281] the CJEU found measures preventing tax credits from being issued to a fully taxable person, due to the dividends being distributed from a non-resident company, restricted and violated the free movement of capital.[282] Objective comparability was met since double taxation, which the measure sought to eliminate, was a risk to both persons.[283] The principle of territoriality did not prevent the extension of tax credits and did not, therefore, justify the measure.[284] The tax system's cohesion was rejected because the measure sought to prevent double taxation which was not threatened by an extension of tax credits and could be achieved using other measures.[285] *Manninen* is believed to extend to corporations.[286] Together, *Lenz* and *Manninen* clearly establish that foreign dividends treated less favourably constitutes a restriction.[287] In both cases, the principle of mutual recognition was endorsed by placing the burden of corporate tax paid in other Member States on an equal footing to that of domestic corporate tax.[288]

In *Sofina*,[289] the CJEU considered a French measure that subjected dividends, distributed by resident companies to non-resident companies to a withholding tax, when the same dividends distributed to resident companies were taxed at the end of the financial year if the company was profit making and under certain situations, was never taxed.[290] The measure

[278] ibid paras 34, 36-40.
[279] ibid paras 44, 46, 48-49.
[280] Theodore Georgopoulos, 'Can Tax Authorities Scrutinise the Ideas of Foreign Charities? The ECJ's Persche Judgment and Lessons from US Tax Law' (2010) 16(4) European Law Journal 458, 472.
[281] Case C-319/02 *Petri Manninen* [2004] ECR I-07477.
[282] ibid paras 18, 24.
[283] ibid paras 33, 36.
[284] ibid para 38.
[285] ibid paras 40, 44-46, 48-49.
[286] Barry and Healy-Rae (n 18) 140.
[287] ibid.
[288] Julian Ghosh, 'Tax Law and the Internal Market: A Critique of the Principle of Mutual Recognition' (2014) 16 CYELS 189, 213.
[289] Case C- 575/17 *Sofina SA, Rebelco SA, Sidro SA v Ministre de l'Action et des Comptes Publics* [2017] OJ C 437/19.
[290] ibid para 22.

restricted the movement of capital.[291] The situations were objectively comparable.[292] The allocation of taxing powers was rejected because France could still tax non-residents when they became profitable if the measure was extended, and if they remained loss-making, the risk of lost tax revenues was no greater than with resident companies and such risks cannot justify violations.[293] Effective tax collection was rejected because extending the measure to non-residents would not interfere with its aim.[294]

In *Amurta*,[295] the CJEU considered Dutch legislation which, where certain conditions were met, would levy a withholding tax on dividends distributed by resident companies and received by non-resident EU companies, while exempting that tax where the recipient was either within the scope of Dutch corporation tax or had a Dutch permanent establishment which owned shares in the distributing company.[296] The CJEU found the measure was restrictive and considered possible justifications.[297] The situations were objectively comparable.[298] The measure was not justified using the cohesion of the tax system because extending the exemption would not prevent the aim of eliminating double taxation.[299] The balanced allocation of taxing powers was also rejected because the Netherlands had not taxed recipient companies in its own territory.[300] The measure was therefore not justifiable.[301]

Test Claimants,[302] considered British legislation using the exemption method for nationally sourced dividends while using the imputation method for foreign-sourced dividends where the effective taxation level of profits in the state was lower than the normal tax rate.[303] A restriction of capital was found.[304] The CJEU considered whether the measure was justified on the basis of 'coherence of the national tax system'.[305] While the measure was appropriate

[291] ibid paras 41, 42.
[292] ibid paras 43, 54.
[293] ibid paras 56, 59-63.
[294] ibid paras 65-67, 77-78.
[295] Case C-379/05 *Amurta SGPS v Inspecteur van de Belastingdienst/ Amsterdam* [2007] ECR I-09569.
[296] ibid para 15.
[297] ibid para 29.
[298] ibid paras 32-33, 41.
[299] ibid paras 42, 51.
[300] ibid paras 53, 59.
[301] ibid para 60.
[302] Case C-35/11 *Test Claimants in the FII Group Litigation v Commissioners of Inland Revenue and The Commissioners for Her Majesty's Revenue & Customs* [2012] ECLI-707.
[303] ibid para 36.
[304] ibid para 54.
[305] ibid para 56.

for this aim, it went beyond what was necessary.[306] Less restrictive measures such as taking account of the nominal rate of tax were available.[307] Therefore, the measure could not be justified.[308]

The CJEU will therefore accept a range of justifications although they can only be used where there are no less restrictive means of achieving the same result.

2.4.4 Free Movement of Capital Conclusion

The free movement of capital has successfully been used to mandate and enforce equal treatment in the field of EU corporate taxation. It can be applied to third-country situations and can be used to tackle purely restrictive measures. However, it has been used most successfully for tackling intra-EU discriminatory measures. In this area, it has helped to minimise many of the differences between the different EU corporate tax systems which subsequently helps address the problems discussed in Chapter One. Nevertheless, several problems with relying on free movement case law remain, as the next section will discuss.

2.5 The Free Movement Case Law as a Reliable and Effective Form of Harmonisation

There are some key issues with the free movement case law which prevents it from being a reliable source of harmonisation. The first issue is that the case law suffers from legal uncertainty. Uncertainties surrounding restrictions and justifications creates an 'unacceptable level of unpredictability'.[309] The CJEU's inconsistencies have contributed to such unpredictability,[310] with even Member States unable to predict rulings.[311] The doctrine of legal precedence is disregarded,[312] which is particularly perplexing to English judges where

[306] ibid paras 59-60.
[307] ibid para 62.
[308] ibid para 65.
[309] Snell, 'Non-discriminatory tax obstacles' (n 260) 354-355.
[310] Peter J Wattel, 'EC law does not require most-favoured nation tax treatment and a disparity is not a discrimination: D. v Inspecteur van de Belastingdienst' [2005] BTR 575, 576.
[311] Lyons (n 139) 399-400.
[312] Eden (n 1) 648-52.

the doctrine is central to the legal system.[313] This leaves all Member States, even those who are responsive to judgments,[314] vulnerable to taxpayer challenges.[315]

A key area of uncertainty is whether non-discriminatory restrictions are prohibited. Other than in *Caster*,[316] the CJEU has been cautious to find violations only where discrimination is evident, particularly when examining the free movement of capital which was initially considered to be less important than the other freedoms.[317] The independent exercise of separate fiscal sovereignty where restrictions arise are permitted so long as such sovereignty is not exercised in a discriminatory manner.[318] However, the CJEU has previously imposed a duty of mutual recognition for the free movement of goods and while this chapter has demonstrated that the mutual recognition of goods and corporate tax are not analogous, the existence of *Caster* means that the extent to which non-discriminatory restrictions will be permitted remains uncertain. Furthermore, this current requirement of a discriminatory element adds uncertainties for companies who will not know whether the treaty freedoms will protect them from additional costs when operating in another Member State. While differentiation between discriminatory and non-discriminatory restrictions is logical, such differentiation does not alter the effect on compliance costs for MNEs discussed in Chapter One.[319]

Furthermore, the case law is also not reliable because positive harmonisation does not emerge from the case law. The CJEU decides the correct interpretation of EU law but can neither dictate how Member States should respond,[320] nor enact 'positive standards'.[321] Taxation can only be considered as part of the freedoms analysis.[322] The reactive nature of the decisions prevents any clear policy from emerging.[323] It also means that tax rules are diverse and complex.[324] Furthermore, the constant findings of incompatibility hinder the ability of Member States to form 'coherent national tax rules'.[325] The updating of tax rules also represents 'costs and constraints' for MNEs complying with them.[326] Member States

[313] ibid.
[314] Vanistendael, 'Company taxation' (n 126) 217.
[315] Cussons (n 139) 15.
[316] *Caster* (n 255).
[317] Snell, 'Non-discriminatory tax obstacles' (n 260); Frerichs (n 236).
[318] *SGA* (n 243); *Kerckhaert* (n 247).
[319] See Chapter 1 section 1.2.1.1.
[320] Boutell (n 3).
[321] Vanistendael, 'Company taxation' (n 126) 217.
[322] Eden (n 1) 648-52.
[323] ibid.
[324] Vanistendael, 'Company taxation' (n 126) 217.
[325] Velida Pearce, 'Exiting the fiscal maze' [2003] Euro Law 25, 25.
[326] Vanistendael, 'Company taxation' (n 126) 218.

responded differently to *Lankhorst-Hohorst* with some restricting thin capitalisation rules while others extended them.[327] The asymmetric reaction is 'unsurprising',[328] as each Member State will seek to optimise their tax system when responding, and this can lead to further delays and expenses.[329]

However, the different proportionality tests applied throughout the case law indicates that the CJEU has developed some positive standards. The two most prominent are the *Marks & Spencer* no choice test applied to cross border relief challenges,[330] and the *Thin Cap* framework used in transfer pricing rule challenges.[331] These frameworks were developed in the CJEU's judgments and then continually applied to subsequent case law.[332] Both frameworks attempt to balance the needs of Member States to protect their economies with the rights of persons to exercise their treaty freedoms which suggests a wider theme across the CJEU's judgments. However, such common frameworks are not analogous to a positive harmonisation measure as case law jurisprudence remains open to change and development. The frameworks can act as a guidance as to the CJEU's likely response in particular situations but provides no guarantees. Furthermore, the CJEU is bound by the treaty freedoms and so its ability to strike a balance varies according to the area of case law, with the CJEU previously effectively sanctioning all CFCs.[333] Further differentiations of proportionality can be seen when comparing measures which target individuals with those which target companies in the exit taxes case law, with more burdensome features allowed for the latter.[334] Any positive guidance which can be identified therefore have a narrow applicability which leaves large areas lacking any real positive standards. A positive harmonisation measure would provide genuine positive standards and is thus more suitable than relying on the negative harmonisation derived from the four freedoms case law.

There are concerns over the quality of CJEU judgments. The CJEU is not 'a specialised tax court',[335] and it has been accused of failing to grasp 'certain fundamentals of tax law' and misunderstanding international tax methods and the implications of their judgments for

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[327] Barry and Healy-Rae (n 18) 138.
[328] Rita de la Feria and Clemens Fuest, 'The economic effects of EU tax jurisprudence' (2016) 41(1) EL Rev 44, 67-68.
[329] Panayi 'Reverse subsidiarity' (n 15) 300.
[330] *Marks & Spencer* (n 73) para 55.
[331] *Thin Cap* (n 174) paras 82-83, 88-90.
[332] *Oy AA* (n 98); *Lidl Belgium* (n 106); *X Holding* (n 111); *Masco Denmark* (n 182); *SGI* (n 187); *Hornbach-Baumarkt-AG* (n 192); *Impresa Pizzarotti* (n 198).
[333] Eden (n 1) 638-41; *Cadbury Schweppes* (n 127) paras 65-66; Kollruss (n 63) 239-40; Whitehead (n 151).
[334] *National Grid* (n 39) para 85.
[335] Vanistendael, 'Company taxation' (n 126) 217.

Member States' wider tax policies.[336] For instance, tax policy decisions are not given enough weight during the discrimination analysis.[337] Further, while pure economic justifications are not accepted,[338] other justifications such as 'securing the cohesion of the tax system' can be interpreted as economic aims as they ensure 'the relevant income' is taxed.[339] This distinction between explicit economic aims and aims which have economic consequences 'is not entirely clear'.[340] This further detracts from the quality of CJEU judgments. Finally, the CJEU rarely has all relevant information during the preliminary reference procedure.[341]

Despite clear faults which prevent the case law from resolving the differences and problems, it is still welcomed by some as the only realistic option for harmonisation.[342] While it influences the design of Member States' tax systems,[343] several obstacles to cross-border trade remain.[344] The CJEU has consistently held that Member States unhappy with negative harmonisation should concentrate on the EU's legislative process instead of limiting the freedoms.[345] The CJEU's jurisprudence has been likened to 'dropping… a bomb on the tax system[s]' of different Member States.[346] Free movement case law, therefore, provides a vehicle to overcome differences between tax systems even if it has several faults.

Nevertheless, while more progress is made with free movement case law than if there was no free movement case law, the issue of double taxation has not been addressed. Double taxation acts as a restriction on MNEs and the free movement case law's inability to properly tackle and eliminate double taxation means that the only option is harmonisation. Cassis de Dijon was the answer to a lack of harmonisation in the free movement of goods but similar judicial developments are highly unlikely in the field of direct corporate taxation. Positive harmonisation must therefore be explored.

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[336] Eden (n 1) 648-52; Richardson (n 4) 284-85.
[337] Michael J Graetz and Alvin C Warren Jr, 'Income Tax Discrimination: Still Stuck in the Labyrinth of Impossibility' (2012) 121 Yale L J 1118, 1129.
[338] Morris (n 163) 782.
[339] Jukka Snell, 'Economic Aims as a Justification for Restrictions on Free Movement' in dr Annette Schrauwen (ed), *The Rule of Reason: Rethinking Another Classic of European Law* (Europa Law Publishing 2005) 35, 37 and 48.
[340] ibid 47-49.
[341] Vanistendael, 'Company taxation' (n 126) 217.
[342] Eden (n 1) 648-52.
[343] Bousfield, Wittmann and Lewen (n 91).
[344] Luca Cerioni, 'The barriers to the international mobility of companies within the European Community: a re-reading of the case law' [1999] JBL 59, 77.
[345] Jan-Mikael Bexhed and Philip Woolfson, 'Safir v Skattemyndigheten i Dalarnas Lan (C118/96)' (1998) 6(9) Int ILR 306, 308.
[346] Frans J Vanistendael, 'The making or br(e)aking of Europe or the challenges for a European tax policy' (2000) 1(1) EBOR 109, 116.

Chapter 3: The Effectiveness of Article 107 as a Means of Negative Harmonisation

3.1 Introduction

Article 107(1) TFEU contains the EU's State aid rules.[1] Similar to the other form of negative harmonisation, the free movement provisions, Article 107(1) must be complied with when Member States exercise their competence over direct taxation.[2] Article 107 tackles tax competition by targeting selective national tax regimes and by targeting tax rulings that facilitate tax avoidance behaviours of Member States. This link was made explicit in 1997 and 1998.[3] This chapter begins by analysing Article 107's criteria before evaluating three categories of Commission decisions. Chapter Three will conclude by assessing the suitability of Article 107 as a means of corporate tax harmonisation.

3.2 The Criteria and Purpose of Article 107

State aid rules are part of the foundation of the internal market, neutralising the 'conditions of competition' for participants in the internal market.[4] They are a natural response to controlling the relationship between sovereign Member States who have the power to choose their own economic policies and the obligations created by the Member States when they signed up to the economic policy commitments of the EU.[5] State aid is a 'major source of

[1] Consolidated version of the Treaty on the Functioning of the European Union (TFEU) [2016] OJ C202/1, art 107 (1).
[2] Commission notice on the application of the State aid rules to measures relating to direct business taxation [1998] OJ C384/3; 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 [2016] OJ C262/1, 1.
[3] Lilian V Faulhaber, 'The Trouble with Tax Competition (Proceedings) Annual Conference on Taxation and Minutes of the Annual Meeting of the National Tax Association' (2017) 110 National Tax Association 1, 23.
[4] Rita Szudoczky and Alicja Majdanska, 'Designing Co-operative Compliance Programmes: Lessons from the EU State Aid Rules for Tax Administrations' [2017] BTR 204, 210.
[5] Christopher Bright, 'Article 90, economic policy and the duties of Member States' (1993) 14(6) ECLR 263, 264.

distortion of competition'.[6] Without controls, wealthier Member States could outspend less economically developed Member States, and the overall aim of greater social cohesion would be undermined.[7] State aid controls were originally implemented to tackle protectionism.[8] State aid controls are used by the current Commission where they have no explicit competence such as corporate tax.[9] For example, challenging corporate tax rulings and practices of Member States that it believes harms the distribution of taxes between Member States.[10] Such rulings are not 'per se' incompatible with Article 107.[11] Although they can constitute State aid in some circumstances. The Commission has suspected Member States of using 'secret administrative rulings' to provide advantages through lowering tax liabilities.[12]

State aid controls are important because, in the EU, State aid may be the only way to support national industries.[13] State aid has the potential to offset the efficiencies which increased harmonisation within the EU has achieved.[14] It poses a threat to the proper functioning of the internal market.[15] The EU's treaties regulating competition in the internal market presumes that competition is 'intrinsically' good, 'produces desirable outcomes' and 'reflects economic liberty'.[16] State aid controls were designed widely by referring to 'any form'.[17] The broad nature of EU State aid controls means that tax exemptions easily fall within its

[6] Alex Nourry, 'The new Procedural Regulation on the application of the E.C. state aid rules' (1999) 10(5) ICCLR 145, 145.
[7] Simon Bishop, 'The European Commission's policy towards state aid' (1997) 18(2) ECLR 84, 84.
[8] Apurva Vats, 'Tax rulings and EU state aid: lessons to be learnt form the Apple-Ireland case' (2021) 42(2) ECLR 80, 80; See Fiona G Wishlade, 'Competition policy, cohesion and the co-ordination of regional aids in the European Community' (1993) 14(4) ECLR 143, 143 for a breakdown of historical State aid spending.
[9] Liza Lovdahl Gormsen, 'State Aid and Direct Taxation and the Big Eruption between the U.S. and the EU' (2017) 62 Antitrust Bull 348, 357.
[10] Nicholas J DeNovio, Elisabetta Righini and Nicolle Nonken Gibbs, 'State Aid: What It Is, and How It May Affect Multinationals and Tax Departments' (2016) 68 Tax Exective 15, 17.
[11] Tony Joris and Wout De Cock, 'Is Belgium and Forum 187 v. Commission a Suitable Legal Source for an EU "At Arm's Length Principle"?' (2017) 16(4) EStAL 607, 611.
[12] Ruth Mason, 'A New Era of State Aid, (Proceedings) Annual Conference on Taxation and Minutes of the Annual Meeting of the National Tax Association' (2018) 111 National Tax Association 1, 40.
[13] Claus-Dieter Ehlermann, 'Managing monopolies: the role of the state in controlling market dominance in the European Community' (1993) 14(2) ECLR 61, 65.
[14] Eugene G Stuart, 'Recent developments in EU law and policy on state aids' (1996) 17(4) ECLR 226, 227.
[15] Rosa Greaves, 'Autonomous regions, taxation and EC state-aid rules' (2009) 34(5) EL Rev 779, 779.
[16] Stephen Daly, 'The power to get it wrong' (2021) 137 LQR 280, 280.
[17] Trevor Soames and Alan Ryan, 'State aid and air transport' (1995) 16(5) ECLR 290, 293.

scope.[18] They are usually considered 'indirect aid', meaning the Member State does not necessarily lose money but instead suffers 'a loss or non-realisation of revenue'.[19] However, the application of State aid controls to direct taxation can be difficult.[20]

There are four State aid requirements. There must be an advantage, which is selective, which is derived from state resources and which creates a distortion.[21] Certain derogations, such as the development of less economically developed regions, exist.[22] An advantage exists where the 'recipient receives a benefit it would not have received under normal market conditions'.[23] Essentially, the taxpayer is exempt from a tax and the exemption is separate from any general tax rule of the Member State.[24] The comparison to normal circumstances is known as the 'market investor' test.[25] However, the findings of tax advantages have been criticised since the advantages are often attributable to multiple factors, including the mismatch between different tax systems,[26] and do not necessarily derive from the contested measure.

Secondly, the Member State must use their state resources. Where the Member State introduces legislation that has the effect of advantaging particular undertakings more than other undertakings, but state resources are not used either directly or indirectly, the measure is not considered State aid.[27] State resources may not be immediately apparent where the relationship between public undertakings and government bodies are complex, making subsidies difficult to detect.[28] *Preussen Elektra* also confirmed that a direct or indirect 'transfer' of state resources was needed and that legislation dictating that undertakings must

[18] Andrew Evans, 'Privatisation and state aid control in E.C. law' (1997) 18(4) ECLR 259, 261; Christian Koenig and Andreas Bartosch, 'E.C. state aid law reviewing equity capital injections and loan grants by the public sector: a comparative analysis' (2000) 21(8) ECLR 377, 377; Juraj Gyarfas, 'Looking for the beneficiary: state aid recovery after a share deal' (2012) 33(1) ECLR 40, 42.
[19] Dr Geert Van Calster, 'Greening the E.C.'s state aid and tax regimes' (2000) 21(6) ECLR 294, 307-08.
[20] David R A Goris and Suzan P T Lap, 'E.U. state aid policy and direct business taxation' (2002) 13(1) ICCLR 37, 38.
[21] TFEU [2016], art 107 (1).
[22] Ehlermann (n 13) 64-65.
[23] Goris and Lap (n 20).
[24] ibid 39.
[25] Kelyn Bacon, 'The concept of state aid: the developing jurisprudence in the European and UK courts' (2003) 24(2) ECLR 54, 55.
[26] Pierpaolo Rossi-Maccanico, 'A New Framework for State Aid Review of Tax Rulings' (2015) 14(3) EStAL 371, 372.
[27] Case C-189/91 *Petra Kirsammer-Hack v Nurhan Sidal* [1993] ECR I-06185.
[28] Leigh Hancher, 'State aids and judicial control in the European Community' (1994) 15(3) ECLR 134, 135.

purchase certain energy above the market price would not constitute State aid.[29] The requirement also means that an MNE which is able to benefit from the differences between corporate tax systems across the EU Member States will not be in receipt of State aid where the Member States have not granted subsidies or foregone tax revenues.[30] However, tax exemptions meet this broadly interpreted requirement easily.[31] Any measure resulting in a Member State receiving less tax from an undertaking meets this requirement.[32] Tax exemptions constitute State aid, while legislation that confers an advantage does not since tax exemptions lower the tax revenues of Member States and require Member States to forgo state resources. The CJEU, therefore, considers them to be the same as a subsidy which would have the same effect. National legislators who introduce laws requiring certain products to be bought above market price or introduce laws requiring only certain companies to follow specific labour laws are not interfering with the State resources derived from tax revenues.

Thirdly, distortions or effecting intra-community trade requires only that the recipient engages in cross-border economic activity.[33] When the financial position of an undertaking is strengthened, part of the fixed costs will be met by the aid, which subsequently increases the amount of capital an undertaking has to invest elsewhere in their company.[34] Where a measure strengthens the financial position of an undertaking in the EU compared to its competitors, the measure is liable to affect intra-Union trade.[35]

Finally, the selectivity requirement presents the greatest challenge when proving that a tax ruling constitutes State aid under Article 107 TFEU.[36] It requires that State aid benefits only a select number of undertakings or a select number of goods.[37] Essentially, it determines whether some undertakings are advantaged more than others.[38] When the measure benefits a

[29] Case C-379/98 *PreussenElektra AG v Schhleswag AG, in the presence of Windpark Reußenköge III GmbH and Land Schleswig-Holstein* [2001] ECR I-02099. Also see, Goris and Lap (n 20) 39.
[30] *Commission Decision on the Groepsrentebox scheme which the Netherlands is planning to implement* (C4/2007) Commission Decision 2009/809/EC OJ L288/26, para 117.
[31] Bacon (n 25) 57; Case 30-59 *De Gezamenlijke Steenkolenmijnen in Limburg v High Authority of the European Coal and Steel Community* [1961] ECR 00001.
[32] Szudoczky and Majdanska (n 4) 216.
[33] Goris and Lap (n 20) 41.
[34] Phedon Nicolaides, 'Compensation for public service obligations: the floodgates of state aid? (2003) 24(11) ECLR 561, 569.
[35] Szudoczky and Majdanska (n 4) 229.
[36] Claire Micheau, 'Tax selectivity in European law of state aid: legal assessment and alternative approaches' (2015) 40(3) EL Rev 323, 324.
[37] Goris and Lap (n 20) 40.
[38] Bacon (n 25) 58.

large number of beneficiaries, the existence of a selective advantage rests on whether companies in a similar or comparable situation are also able to benefit.[39] By only advantaging a select number of undertakings or advantaging some more than others, the Member State creates a disadvantage for the competitors of the recipient undertaking.[40] However, regardless of if certain undertakings are more advantaged than others, the measure does not meet the selectivity criterion where it is a general measure.[41] The tax measure may be considered a general measure if it is part of the general characteristics and purposes of the Member States' tax system.[42] The general characteristics argument is often used by Member States because their tax regimes are highly complex, and it is rare to find a measure that will not advantage some taxpayers more than others.[43] Reductions in the general rate are not selective.[44] Moreover, the assessment is made in relation to the Member States' laws meaning a Member State which selectively lowers the tax burden for a specific group of taxpayers may contravene Article 107 despite another Member State not contravening Article 107 with a lower general rate.[45]

A measure can be selective on the basis of 'material or geographical considerations'.[46] Material selectivity may be de jure selective, where the measure explicitly limits itself to certain undertakings, or de facto selective where despite there being no explicit limitation on which undertakings can benefit, in practice only certain undertakings benefit.[47] All corporate tax rulings discussed in this chapter are de jure or de facto materially selective. Material selectivity may also be divided into measures limited to particular sectors or activities and

[39] John Temple Lang, 'Autogrill Espana and Banco Santander: the concept of "general" tax measures clarified for state aid' (2015) 40(5) EL Rev 763, 764.
[40] Hans Weenink and Petra Schulze Steinen, 'State aid in the financial services sector' (2008) 23(10) JIBLR 514, 516.
[41] Bacon (n 25) 58.
[42] Waltraud Hakenberg and Friedrich Erlbacher, 'State aid law in the European courts in 2001 and 2002' (2003) 24(9) ECLR 431, 433.
[43] 'Company taxation, state aid and fundamental freedoms: is the next step enhanced cooperation?' (2005) 30(2) EL Rev 209, 224.
[44] Greaves (n 15) 782.
[45] Raymond HC Luja, 'Will the EU's State Aid Regime Survive BEPS?' [2015] BTR 379, 381.
[46] Bartlomiej Kurcz, 'How selective is selectivity? A few thoughts on regional selectivity' (2007) 66(2) CLJ 313, 314.
[47] Micheau (n 36) 325; Chantal C Renta, 'A Cute Cowboy Stole Our Money: Apple, Ireland, and Why the Court of Justice of the European Union Should Reverse the European Commission's Decision' (2018) 24 Sw J Int'l L 177, 197.

measures horizontally selective where only certain undertakings benefit based on whether their situations meet certain criteria.[48]

The three-step test creates legal uncertainty.[49] The three-step analysis identifies materially selective tax measures. The first step is to identify the reference system,[50] which is the part of the tax system which would have been applied if the alleged State aid had not occurred. The second step identifies whether the relevant tax measure derogates from the reference system.[51] The final step determines whether the derogation can be justified.[52] The measure can be justified if it is part of the nature or general scheme inherent to the Member States' tax system and complies with the principle of proportionality.[53]

However, the three-step analysis is not always appropriate. If the measure is facially neutral and does not fulfil the three-step analysis but has the same effect as a measure that does, then the contested measure can still be selective.[54] In *Gibraltar*, the CJEU held that a tax measure designed 'to favour certain undertakings which are in a comparable situation' could be selective without fulfilling the three-step test.[55] However, in *Gibraltar*, the measure was intentionally designed to be selective while outside the scope of Article 107 and this influenced the judgment.[56] The intention of attracting offshore companies was also considered relevant by the ECJ.[57] Thus, it is the effect and intention of the measure which decides whether the selectivity criterion is met.[58] Furthermore, the *Gibraltar* judgment has been criticised for relying on a hypothetical comparator rather than a real-life comparator which is usually used.[59] While *Gibraltar* aids simplicity by avoiding 'formalism and dogmatic discussions' through prioritising effects, such a prioritisation is not beneficial

[48] Luis Miguel Perdiago Borrego, 'State Aid Law and Taxation' (2016) 7 Bocconi Legal Papers 97, 132.
[49] Ulrich Soltész, 'EU state aid law and taxation - where do we stand today?' (2020) 41(1) ECLR 18, 19.
[50] Commission notice on the notion of State aid [2016] (n 2) para 133.
[51] ibid para 135.
[52] ibid para 139.
[53] Szudoczky and Majdanska (n 4) 224-225.
[54] Ruth Mason and Leopoldo Parada, 'Company Size Matters' [2019] BTR 610, 628.
[55] Case C-106/09 *European Commission v Government of Gibraltar and United Kingdom of Great Britain and Northern Ireland* [2011] ECR I-11113.
[56] Mason and Parada (n 54) 628; Thomas Jaeger, 'Tax Concessions for Multinationals: In or Out of the Reach of State Aid Law?' (2017) 8(4) JECL & Pract 221, 225.
[57] Edoardo Traversa, 'State Aid and Taxation' (2014) 13(3) EStAL 518, 521.
[58] Phedon Nicolaides, 'The Definition of the Reference Tax System Is Still a Puzzle' (2018) 17(3) EStAL 419, 425.
[59] John Temple Lang, 'The Gibraltar State Aid and Taxation Judgment – A "Methodological Revolution"?' (2012) 11(4) EStAL 805, 812.

when it lacks clearly structured arguments.[60] However, this approach increases the case law's consistency.[61] In *Gibraltar*, the ECJ interpreted the whole tax system as 'selective and expressly designed' to offer economic advantages.[62] Additionally, the existence of a derogation from the reference framework does not prove selectivity where there is no restriction on which undertakings may benefit.[63] The focus is on whether there is actually an exception only available to some undertakings.[64]

Many recent tax rulings involve advanced pricing agreements ('APAs'). APAs are selective so long as the tax administration has discretion and not all taxpayers in a 'similar legal and factual situation' are able to access the rulings.[65] APAs are advanced agreements between tax administrators and MNEs regarding the method which will be used to determine the arm's length price of intra-group transactions.[66] APAs offer MNEs certainty and allow MNEs to predict their taxable profits.

3.3 Profit Allocation Rulings and Reflecting Economic Reality

The first category of decisions is profit allocation rulings. The artificial allocation of profit was identified in Chapter One. The first decision, the *Apple Decision*, concerns profit allocation between two companies in the same Member State. The three other decisions concern profit allocation between companies of more than one Member State. Many of the cases concern advance rulings which are where tax administrations confirm the tax treatment of transactions in advance of the transaction taking place. Transfer pricing, as detailed in the first chapter, allows an MNE to influence the location of its taxable profits and therefore

[60] Thomas Jaeger, 'From Santander to LuxLeaks – and Back' (2015) 14(3) EStAL 345, 349-350.
[61] Begoña Pérez-Bernabeu, 'Refining the Derogation Test on Material Tax Selectivity' (2017) 16(4) EStAL 582, 586.
[62] Lorenzo Panci, 'Latest Developments on the Interpretation of the Concept of Selectivity in the Field of Corporate Taxation' (2018) 17(3) EStAL 353, 359.
[63] Jacques Derenne and Mateo Domecq, 'Survey Key Developments in State Aid Law' (2016) 7(2) JECL & Pract 135, 137-138.
[64] Phedon Nicolaides, 'New Limits to the Concept of Selectivity: The Birth of a 'General Exception' to the Prohibition of State Aid in EU Competition Law' (2015) 6(5) JECL & Pract 315, 322.
[65] James Kavanagh and Nicole Robins, 'Corporate Tax Arrangements under EU State Aid Scrutiny' (2015) 14(3) EStAL 358, 360.
[66] Rossi-Maccanico, 'A New Framework for State Aid Review' (n 26) 374.

lower its tax liability in high tax Member States.[67] The increased number of transfer pricing investigations has led to accusations that the Commission interferes with Member States' tax laws.[68]

3.3.1 *Apple* – Value Creation and Retroactivity

The contested tax rulings meant that ASI and AOE (part of the Apple group) were neither tax-resident in Ireland nor internationally.[69] After determining the rulings were financed through state resources, liable to affect trade and distort competition, and constituted an advantage, the three-step analysis was considered.[70] The Irish corporate tax system was the reference system since all corporate taxpayers were subject to the same tax with the objective of taxing profits taxable in Ireland.[71] A selective advantage to the extent ASI and AOE's tax liability was lowered was found since the rulings allowed them to determine their taxable profits (and thus their tax liability) annually, and the determined taxable profits were lower than had the arm's length principle been used since unreliable and unsubstantiated claims about IP were accepted by Irish tax authorities which departed from 'a market based outcome in line with the arm's length principle'.[72] With no justifications, the measure constituted a selective advantage and thus State aid.[73] The Commission argued that the arm's length principle was derived from the ECJ's interpretation of Article 107 and was applicable irrespective of whether Ireland had independently incorporated the principle.[74]

The Decision was annulled for failing to meet the 'requite legal standard' for demonstrating a selective advantage.[75] The Commission's errors included its assessment of Irish tax law and its analysis of ASI and AOE, which meant its primary line of reasoning failed to demonstrate an advantage.[76] The subsidiary and alternative lines of reasoning were equally erroneous and failed to demonstrate an advantage since arguments of methodological errors

[67] Kiran Desai, 'A development in state aid practice - tax rulings and settlements become a focus of attention' (2014) 35(12) ECLR 575, 579.
[68] Ian Simester, 'A new European "arm's length" principle' (2020) 136 LQR 370, 370.
[69] *Aid to Apple* (SA 38373) Commission Decision (EU) 2017/1283 [2016] OJ L187/1, paras 39, 50-52.
[70] ibid paras 221-223, 226.
[71] ibid paras 227-228, 243.
[72] ibid paras 244-245, 258, 260-261.
[73] ibid paras 405-408, 411-412.
[74] Eugene Stuart, 'Whether or Not to Bite the Apple: Some Implications of the August 2016 Commission Decision on Irish Tax Benefits for Apple' (2017) 16(2) EStAL 209, 224.
[75] Case T-778/16 *Ireland and Others v European Commission* [2020] ECLI-338, para 507.
[76] ibid paras 187, 245, 249, 284, 295, 302, 309, 312.

were insufficiently evidenced or proven, and the comparability study did not prove reduced tax liability.[77] The number of errors made by the Commission demonstrates the difficulty the Commission faces when applying Article 107 to corporate tax situations. However, the Commission has appealed on the grounds that the General Court has erred in its application of the law.[78] The outcome of the appeal will undoubtedly prove influential and determine the effectiveness of Article 107 being used to tackle corporate tax problems outlined in Chapter One.

Overall, Member States still have 'considerable independence' to make their own 'business arrangements' with MNEs.[79] The General Court's annulment of the *Apple Decision* also demonstrates a critical issue with the Commission relying on State aid controls which is that when there is a lack of clear positive harmonisation in an area, relying on negative harmonisation measures can lead to acquisitions that the Commission is 'substituting its own views' for the Member State.[80] The *Apple Decision* represents an attempt by the Commission to tackle tax agreements between Member States and MNEs which facilitate lower tax liability for the MNEs. However, as this Decision has demonstrated, the Commission must respect the line between neutralising the effects of State aid on competition and implementing 'a proactive tax policy' which should be left to the legislator.[81] The rigidity of the criteria means that Article 107 is not a reliable form of negative harmonisation and can only be used to overcome the differences between tax systems when tax regimes fulfil its criteria.

Value creation remains an ongoing issue, with the Commission recently being criticised for seemingly arguing that all of the profits from Apple's non-US operations should have been taxed in Ireland to satisfy the arm's length principle.[82] However, the IP which drives the value of Apple's products was not entirely created in Ireland and attributing all profit to Ireland would not allow the profit to be taxed where it was created.[83] The vast majority of

[77] ibid paras 333, 349, 417, 435, 452, 478, 480-481, 504.
[78] Commission, 'Statement by Executive Vice-President Margrethe Vestager on the Commission's decision to appeal the General Court's judgment on the Apple tax State aid case in Ireland' (Europa 25 September 2020) <https://ec.europa.eu/commission/presscorner/detail/en/statement_20_1746> accessed 24 August 2021.
[79] Vats (n 8) 82.
[80] ibid.
[81] Jaeger, 'Tax Concessions for Multinationals' (n 56) 222.
[82] Sir Philip Lowe, 'The Commission's powers to enforce the law: and to propose changes to it' (2017) 42(6) EL Rev 909, 917.
[83] ibid.

value creation for Apple takes place in the United States.[84] This new concept, economic nexus, is arguably the best profit allocation method for high-tech industries since the effort, expenditure and skill behind the research is what determines the value of products.[85] For Apple, the products were designed and developed in the United States, which is why the United States incorporated companies were entitled to claim most of the profit.[86]

The issue of retroactivity is also highlighted as the first contested tax measure was in 1991.[87] Even if the Commission had successfully defended its Decision before the General Court in 2020, Apple would have been able to benefit from the contested measure for 29 years. During that time, they would have been able to increase their investments. The length of time also meant that the Commission only required Apple to pay back the tax exemption they received from 2004. As such, the *Apple Decision* would not have put Apple in the same position as it would have been without State aid. This, in conjunction with no financial penalties for the Member States themselves, limits the extent to which the use of Article 107 will actually deter Member States from offering competitive tax rulings.

The choice of reference system has also been criticised, with the Commission receiving criticism for not comparing Apple's tax rulings with the tax treatment of MNEs in Ireland.[88] The failure to recognise the difference between integrated and non-integrated companies when determining the reference system is part of much wider criticism aimed at the Commission, which alleges that the reference systems chosen are not properly decided and are often too wide, which has the effect of making it easier for the Commission to demonstrate that derogations have occurred.[89] In particular, it has been argued that since the Commission accepts that only some MNEs benefitted from Ireland's tax rulings, the Commission should have analysed the selectivity criterion using the corporate tax treatment of MNEs as the reference system.[90]

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[84] David Russell and Toby Graham, 'Editorial The EU Commission's finding that Irish tax rulings in relation to Apple amounted to illegal state aid; reflections on this and the legislative underpinning of Common Reporting Standard' (2016) 22(10) Trusts & Trustees 1039, 1042-1044.
[85] James G S Yang, A Seddik Meziani and Yali Shen, 'Understanding Apple's Global Tax Strategy in Ireland' (2016) 42 International Tax Journal 41, 46.
[86] ibid.
[87] *Aid to Apple* (SA 38373), paras 4, 7, 39.
[88] Adrien Giraud and Sylvain Petit, 'Tax Rulings and State Aid Qualification: Should Reality Matter' (2017) 16(2) EStAL 233, 238.
[89] ibid.
[90] ibid.

3.3.2 *Amazon* – Reflecting Market Conditions

The transfer pricing arrangements of two Amazon subsidiaries (LuxOpCo and LuxSCS) accepted by Luxembourg allowed LuxOpCo to artificially lower its taxable profits as the transfer prices and the analysis of the assets used, functions performed and risks assumed did not reflect economic reality, thus constituting an advantage.[91] The measures were financed through state resources, liable to affect intra-Union trade and distort competition and the individual nature of the ruling, contained in letters addressed to LuxOpCo, gave rise to the presumption of selectivity.[92] In any case, the three-step analysis also demonstrated selectivity and with no justifications, the measure was both selective and State aid.[93]

The Decision was annulled by the General Court since both the primary finding of an advantage and the subsidiary arguments were incorrect.[94] Regarding the former, the primary reasoning failed to establish that the royalty was under-priced and LuxOpCo's tax burden was artificially reduced since the functional analysis was incorrect, no advantage was proven and the remuneration analysis was also erroneous.[95] Regarding the latter, the subsidiary arguments failed to prove the existence of an advantage since they did not prove that methodological errors led to an undervaluation of the remuneration received by LuxOpCo.[96] The *Amazon Decision* demonstrates that the Commission's emphasis on requiring profit allocation agreements to reflect market conditions. It also demonstrated the difficulties of assessing what economic reality is in the context of large complex companies.[97]

3.3.3 *Starbucks* and Fiat – The New and Uncertain European Arm's Length Principle

In *Starbucks*, the Netherlands accepted remuneration levels set in the Starbucks' transfer pricing report, which decided that royalty paid by SMBV (Dutch Starbucks subsidiary) to Alki LP (UK incorporated) would be calculated annually as the difference between 'the realised operating profit before royalty expenses' and the mark-up representing operating expenses.[98] After determining that the ruling was imputable to the Netherlands, financed

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[91] *Aid to Amazon – Luxembourg* (SA 38944) Commission Decision (EU) 2018/859 [2017] OJ L153/1, paras 402-403.
[92] ibid paras 394-397, see 584 for presumption.
[93] ibid paras 585-603, 605.
[94] Case T-816/17 *Grand Duchy of Luxembourg , Amazon EU Sàrl and Amazon.com, Inc v European Commission* [2021] ECLI-252.
[95] ibid paras 296-297.
[96] ibid paras 537-538, 564-565, 587-590.
[97] Antony Ting, 'Intangibles and the Transfer Pricing Reconstruction Rules: A Case Study of Amazon' [2020] BTR 302, 306-309.
[98] *State aid implemented by the Netherlands to Starbucks* (SA 38374) Commission Decision (EU) 2017/502 [2015] OJ L83/38, paras 37-40, 43-44.

through State resources and liable to affect intra-Union trade and distort competition, the Commission considered the three-part test and chose the general corporate income tax regime as the reference system.[99] The contested measure derogated by accepting transfer pricing methodologies which lowered the taxable profits compared to what SMBV would have paid under the reference systems determined by the market.[100] In the absence of justifications, the contested measure constituted a selective advantage and thus State aid.[101]

In *Fiat*, Luxembourg granted an advanced ruling to FFT (part of the Fiat Group), which accepted the use of the transactional net margin method in transfer pricing as representing the arm's length principle.[102] After determining that the measure was imputable to Luxembourg, financed through State resources, liable to both affect intra-Union trade and distort competition, the Commission considered the three-step test and determined the reference system to be the corporate income tax regime.[103] Selectivity is presumed with individual measures, and the Commission nevertheless established that there was a selective advantage through a departure from the arm's length principle due to the acceptance of various FTT methodologies, which had the effect of artificially lowering their tax liability as compared to the reference system.[104] In the absence of justifications, the measure constituted a selective advantage and thus was State aid.[105] The Decision relied on comparisons between group and standalone companies, similar to that of the comparison between offshore and other companies in Gibraltar.[106] The Commission has become increasingly willing to make unusual comparisons.

Both decisions were appealed. The *Starbucks Decision* was annulled for failure to 'demonstrate to a requisite legal standard the existence of an advantage' since information not available at the time of the rulings was used, and the Commission erred in its SMBV analysis which meant that none of its reasonings evidenced an advantage.[107] However, the General Court also made findings in favour of the Commission confirming that the Commission could, for instance, classify tax measures as State aid if they met the State aid

[99] ibid paras 225-227, 244.
[100] ibid para 408.
[101] ibid paras 413-415, 422.
[102] *State aid which Luxembourg granted to Fiat* (SA 38375) Commission Decision (EU) 2016/2326 [2015] OJ L351/1, paras 52, 54-55.
[103] ibid paras 187-189, 192, 194.
[104] ibid paras 218, 221, 266, 291, 301.
[105] ibid paras 337-339, 346.
[106] Panci (n 62) 364.
[107] Case T-760/15 *Kingdom of the Netherlands and Others v European Commission* [2019] ECLI-669, paras 205, 216, 250, 264-265, 273, 278, 287, 319, 346, 359, 391, 404, 475, 501, 531, 549, 559-561.

requirements, examine whether intra-group transactions 'were remunerated as though they had been negotiated under market conditions', and use the arm's length principle as a tool for examining the contested measure.[108] In contrast, the *Fiat Decision* was upheld, endorsing the use of the arm's length principle together with confirming that the Commission can 'monitor' Article 107 compliance including by investigating tax rulings by verifying whether specific rules confer advantages on beneficiaries compared to 'normal' taxation and that determining 'normal' taxation does not constitute harmonisation.[109]

3.3.3.1 The New European Arm's Length Principle

A key debate that has arisen from both the *Starbucks* and *Fiat* decisions is whether a new European arm's length principle exists and the legality of the Commission's decision to introduce it to their analyses. The Commission's application of the arm's length principle in both *Starbucks* and *Fiat* has been criticised since the Commission's argument that the European arm's length principle can be derived from Article 107 is disputed.

For example, in *Starbucks*, the Commission maintained that the arm's length principle was derived from Article 107 and it has been argued that the primary reason behind this argument is so that the Commission avoids 'substituting itself for the Dutch authorities interpreting national law'.[110] In both *Starbucks* and *Fiat*, the General Court accepted the Commission's use of a 'new European principle' as opposed to OECD arm's length analysis.[111] The adoption of the new principle is part of a wider issue of consistency in the Commission's use of State aid controls in relation to tax measures. In *Fiat*, the Commission attempted to deviate from its original reliance on the European arm's length principle and argue that the principle was 'inherent in national law' so long as a Member State taxes 'legal rather than economic entities' which unsurprising, the General Court did not allow the Commission to change their legal basis for using the principle.[112]

Neither EU law nor the CJEU has explicitly referred to the arm's length principle as forming part of EU law before both decisions.[113] Past references to the arm's length principle are not

[108] ibid paras 143, 156, 163.
[109] Case T-755/15 *Grand Duchy of Luxembourg and Fiat Chrysler Finance Europe v European Commission* [2019] ECLI-670, paras 107, 112-115, 117, 151, 187, 430.
[110] Panci (n 62) 365.
[111] Simester (n 68).
[112] ibid 372.
[113] Theodoros Iliopoulos, 'The State Aid Cases of Starbucks and Fiat: New Routes for the Concept of Selectivity' (2017) 16(2) EStAL 263, 269; Kyle Richard, 'Are All Tax Rulings State Aid: Examining the European Commission's Recent State Aid Decisions' (2018) 18 Hous Bus & Tax LJ 1, 41.

entirely clear as while it is arguable that the principle was endorsed in *Belgium* and *Forum 187*, this is not entirely clear and the judgment was heavily criticised.[114] The Commission has been accused of 'overstretching' the judgment in Forum 187 and, as such, has also faced criticisms that the judgment is incapable of supporting all of the Commission's later statements.[115]

The Commission's decision to apply the arm's length principle was therefore originally met with 'confusion' and accusations of acting 'ultra-vires' although the Commission clarified that the arm's length principle used in both decisions derived from Article 107.[116] The Commission argues that Article 107 'implies the existence of a general principle of equal treatment' and that the arm's length principle is necessary to enforce that equal treatment.[117] The CJEU has required factually and legally comparable undertakings to be treated equally under Article 107, which supports the notion that a principle of equal treatment derives from Article 107 despite there being no evidence that the arm's length principle will result in the best implementation of Article 107.[118] The implementation of the arm's length principle also does not produce completely equal treatment, which further discredits the Commission's argument that Article 107 implies the use of the arm's length principle.[119]

The endorsement of the European arm's length principle has produced a 'centralised, hypothetical standard' which constitutes a 'narrow, form of harmonisation'.[120] The European arm's length principle can also be used in cases where the laws of Member States' do not contain any arm's length principle so long as the objective of the Member States' corporate tax regime is 'to tax every company's market profits' which is normal of most regimes.[121] While this new development allows the Commission to avoid accusations of acting ultra-vires when applying the arm's length principle, it does not resolve the issue of uncertainty with regards to how the Commission uses State aid controls. The Court has since rejected the Commission's reasoning that the arm's length principle is a core aspect of Article 107 and instead has held that it is an 'instrument' that facilitates the 'application' of Article 107 and that it can be used because the concept is internationally recognised and because the

[114] Joris and De Cock (n 11) 615.
[115] Dimitrios A Kyriazis, 'From Soft Law to Soft Law Through Hard Law' (2016) 15(3) EStAL 428, 435-436.
[116] Iliopoulos (n 113) 269-270.
[117] Fausta Todhe, 'The Rise of an (Autonomous) Arm's Length Principle in EU State Aid Rules' (2019) 18(3) EStAL 249, 257.
[118] ibid 260.
[119] ibid 261.
[120] Simester (n 68) 373.
[121] ibid.

concept is endorsed by the OECD which EU Member States are also members of.[122] Despite the General Court dismissing fears of tax harmonisation, a European arm's length principle has developed, which also gives rise to the potential of other pan-European Principles being developed.[123]

The uncertainty limits the extent to which Member States are likely to respond to State aid decisions and amend their own tax rulings.[124] The uncertainty which arises as a result of the number of State aid decisions that have been annulled by the General Court, and the possibility that the ECJ may interpret the decisions differently, also limits the incentive Member States have for changing their tax rulings practices to meet the Commission's standards which are highly likely to change.

3.4 The Challenges of Tackling National Tax Regimes

3.4.1 Belgium *Excess Profits* – Tackling Harmfully Selective Regimes

Unlike most of the recent Commission decisions, which investigate individual tax rulings, the *Belgium Excess Profits Decision* investigated an entire scheme.[125] Foreign resident multinational companies' permanent establishments ('Belgian group entities') could, upon receiving an advance ruling, deduct excess profits from their recorded profits.[126] Excess profits were actual profits minus hypothetical average profits of comparable standalone companies.[127] The scheme's purpose was to tax only arm's length profit and not those profits arising from synergies and other advantages of group companies.[128] The scheme was imputable to Belgium, financed through state resources, liable to affect intra-Union trade and distort competition, and conferred an advantage via the downward adjustment.[129]

Under the three-step selectivity analysis, the reference system was the Belgian corporate income tax system since its objective was taxing all profits of companies subject to Belgian

[122] Sandra Marco Colino, 'The Long Arm of State Aid Law: Crushing Corporate Tax Avoidance' (2020) 44 Fordham Int'l LJ 397, 457.
[123] Simester (n 68) 373.
[124] ibid 375.
[125] Falk Schöning and David Dauchez, 'Key Developments in State Aid Law' (2017) 8(2) JECL & Pract 126, 129-130.
[126] *Excess Profit exemption in Belgium* (SA 37667) Commission Decision (EU) 2016/1699 [2019] OJ L260/61, para 13.
[127] ibid para 13.
[128] ibid para 14.
[129] ibid paras 113-117.

tax.[130] The Commission refuted arguments that adjustments were inherent to the reference system because accepting such arguments would allow Member States to circumvent Article 107 through legislating exemptions.[131] The scheme constituted a derogation since permanent establishments are usually taxed on recorded profits.[132] Some corporate entities in a similar position could not access the scheme since the measure was de jure selective and required membership of a multinational group, the rulings only concerned future situations, and in practice, required substantial investments, the creation of employment or the relocation of activities to benefit.[133] Furthermore, only larger or medium-sized multinationals could benefit, giving rise to de factor selectivity.[134] The scheme also derogated from the arm's length principle which was inherent to the reference system.[135] Belgium's justification of preventing double taxation was rejected since the scheme did not require beneficiaries to demonstrate that the relevant profit formed part of associated companies' tax bases and did not, therefore, derive from the reference system.[136] The scheme, therefore, conferred a selective advantage on the beneficiaries.[137] The contested measure was, therefore, State aid for the purposes of Article 107 (1) of the TFEU.[138] The Commission's decision to use the general objective of the wider reference system produced a different outcome than would have been produced if the objectives were those of the excess profit scheme itself.[139] This once again demonstrates the problem of allowing the Commission to choose the reference system.

The impact of the Decision is threefold. Firstly, it highlights the Commission's aversion to acting as an 'arbitrator of the allocation of taxable profits', which is both politically sensitive,[140] and hard to calculate due to the lack of transparency between the different tax systems discussed in Chapter One. The difficulties of calculating taxable profits would be further exacerbated in the context of third countries. It would greatly increase both the time and financial resources necessary for each investigation. Preventing MNEs from choosing where their profits are taxed has been endorsed by the CJEU throughout free movement case

[130] ibid paras 119, 121.
[131] ibid paras 121, 128.
[132] ibid paras 132-133.
[133] ibid paras 136, 138-139.
[134] ibid para 140.
[135] ibid paras 144, 169-170.
[136] ibid paras 172, 174, 181.
[137] ibid para 182.
[138] ibid para 187.
[139] Panci (n 62) 366.
[140] Francois-Guillaume de Lichtervelde, 'The Excess Profit Exemption System is Not an Aid Scheme: Not the Ruling Expected, But Not the End of the Story' (2019) 2019(3) EStAL 382, 384-385.

law as an important tool for preventing tax avoidance. When MNEs have a choice, they inevitably choose to be taxed in a low-tax jurisdiction. Secondly, the Decision highlights how State aid can be used to tackle national measures which attempt to attract FDI through harmful tax competition. As Chapter One highlighted, the key characteristic of harmful tax competition is selectivity. The Belgian measures required the MNE to invest in Belgium to benefit. This undermines the argument that the objective was to prevent double taxation. Finally, the Decision has also been used by the Commission as evidence that American corporations are not targeted for protectionist purposes because, unlike many State aid decisions, most beneficiaries were not based in the USA.[141]

The General Court's subsequent annulment contains two important points.[142] Firstly, the Court confirmed that the Commission did not encroach on Belgium's tax jurisdiction. States have direct tax competence which must be exercised consistently with EU law while the Commission is competent in ensuring Article 107 compliance.[143] Similarly, Member States may prevent double taxation but must comply with EU law.[144] Belgium's measure did not pursue that objective because the beneficiaries did not need to demonstrate that their excess profit formed part of another company's taxable base or that it was taxed in another jurisdiction.[145] The Court, therefore, rejected accusations that the Commission was engaged in harmonisation in disguise.[146] This demonstrates that justifications will be interpreted very narrowly by the Court.

The Court annulled the Decision because the Commission had failed to show that the definition of an aid scheme had been met.[147] Among other concerns, the Commission had only reviewed a third of the rulings and only six in detail, which undermined the Commission's findings of a systematic approach.[148] This is important because the Court did not discuss whether the individual tax rulings could be considered State aid. As such, the Commission is investigating each ruling separately.[149]

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[141] Jan Blockx, 'The Belgian Excess Profit Exemption: Tax Incentives for Multinational Groups as State Aid' (2017) 8(1) JECL & Pract 25, 26.
[142] Case T-131/16 *Kingdom of Belgium and Magnetrol International v European Commission* [2019] ECLI-91.
[143] ibid paras 62-63.
[144] ibid para 71.
[145] ibid para 72.
[146] Colino (n 122) 450.
[147] *Belgium v Commission* (n 142) paras 120, 135-136.
[148] ibid paras 121-134.
[149] 'Commission opens in-depth investigations into Belgian tax rulings granted to 39 multinational companies' [2019] EU Focus 26, 26.

3.4.2 *UK CFC* Rules – Manageability as a Justification

The second recent State aid case concerning national tax regimes is the Commission Decision on UK CFC rules. The Group Financing Exemption was imputable to the UK, financed through state resources, affected intra-Union trade, distorted competition, constituted an advantage by improving 'the net financial position' of beneficiaries and was an aid scheme.[150] Under the three-step analysis, the UK CFC regime was the chosen reference system instead of the more commonly chosen general corporate tax regime, which the UK argued provided the necessary context for the CFC rules but which the Commission believed had different objectives to the CFC rules.[151] The measures constituted a derogation since those NTFPs benefitting from the exemptions were legally and factually objectively comparable to those who did not, and the Commission rejected the UK's two proposed differences that the NTFPs not qualifying firstly had profits which were per se artificially diverted, and secondly, that treaty freedom obligations affected the categories of NTFPs differently.[152] The UK offered two justifications, firstly that it ensured the system was 'manageable and administrable' for HMRC and taxpayers alike and secondly, that it facilitated compliance with freedoms case-law.[153] Addressing the former, the Commission accepted one of the two tests, the connected capital test, as the MNEs 'complex' funding patterns were acknowledged to create difficulties for tracing the origin of funds leading to a burdensome CFC regime and further accepted selective rules aiming to strengthen tax avoidance rules and deriving from 'an inherent mechanism necessary for the functioning and effectiveness of the CFC rules'.[154] The latter justification was considered in the context of the second test, the SPF, which did not restrict the freedom of establishment, which meant it could not be justified under the guise of treaty compliance and the measure, therefore, constituted a selective advantage and State aid when the SPF test was used.[155]

The Decision demonstrates the difficulties of relying on State aid provisions together with the freedoms case law as a means of negative harmonisation. The CFC rules considered in this Decision were a response to a previous finding by the CJEU that the previous CFC rules violated the freedom of establishment. The two forms of negative harmonisation do not complement each other, and as a result, Member States find it difficult to achieve the right

[150] State aid scheme UK CFC Group Financing Exemption (SA 44896) Commission Decision (EU) 2019/1352 [2019] OJ L216/1, paras 33-37, 86-90, 96.
[151] ibid paras 102-104, 106.
[152] ibid paras 124-126, 129, 142, 144, 151.
[153] ibid paras 154.
[154] ibid paras 155, 157, 160, 163-164, 169.
[155] ibid paras 170, 173-175, 177.

balance. Rules which are too selective may contravene Article 107, yet if they are too wide, they may contravene the four freedoms. The Decision also highlights the problems with the choice of the reference system in the three-step selectivity analysis. Determining the reference framework can have a decisive effect on whether selectivity is found.[156] However, despite its importance, there is very little guidance from the CJEU on how the reference system should be determined.[157] In this Decision, the reference system was the UK's CFC regime and not the corporate tax regime, which is usually chosen. By giving the Commission the power to choose the reference system, they also have the power to influence the result of the selectivity criterion.

3.5 Double Non-Taxation Only Prohibited If Selective

3.5.1 *McDonald's* – The Rigidity of the Selectivity Criterion

The Luxembourgish tax administration issued two tax rulings in favour of McD Europe, which was part of the McDonald's group and owned a US Franchise Branch and a Swiss Service Branch.[158] In the former, Luxembourg confirmed that McD Europe was tax resident in Luxembourg and thus benefitted from their double taxation treaties meaning the activities of both branches were exempt from Luxembourgish corporate tax.[159] In the latter, Luxembourg confirmed that despite the US Branch not being taxed in the US, they had no right to recover the right to tax.[160] However, using the three-step analysis, the Commission found no selective advantage because there was no derogation from the double taxation treaty and since both Luxembourg and the USA applied the same provisions, there were no obligations on Luxembourg to overcome problems arising from the different interpretations.[161]

The finding of no State aid demonstrates that US MNEs are not 'unreasonably' targeted.[162] Further, Luxembourg did respond by considering changes that would close the loophole, demonstrating that even negative findings can influence Member States.[163] However, the

[156] Micheau (n 36) 334.
[157] Phedon Nicolaides, 'State Aid Rules and Tax Rulings' (2016) 15(3) EStAL 416, 424-425.
[158] *Alleged aid to McDonald's – Luxembourg* (SA 38945) Commission Decision (EU) 2019/1252 [2018] OJ L195/20, paras 25, 31.
[159] ibid paras 34-36, 38.
[160] ibid paras 39-41, 43, 46.
[161] ibid paras 102, 106, 109, 115, 121, 123-124, 126.
[162] Vats (n 8) 83.
[163] 'Commission investigation finds Luxembourg did not give selective tax treatment to McDonald's' [2018] EU Focus 20, 21.

Decision also demonstrates a fundamental flaw of relying on State aid to harmonise direct taxes. Luxembourg knew that McDonald's paid no tax, yet because they applied their rules objectively, the selectivity criterion was not fulfilled.[164] Member States can continue to design regimes to attract FDI so long as they circumvent the exact Article 107 requirements.

3.5.2 *Engie* – Derogating from General Rules

The *Engie* ruling concerned internal double non-taxation in relation to the tax treatment of loans received by Engie subsidiaries to finance the transfer of assets from other members of the Engie group.[165] As a result, Engie avoided tax on 99% of their products derived from Engie LNG Supply and Engie Treasury Management in Luxembourg.[166] After assessing that the measure met all other requirements, the Commission applied the three-step selectivity analysis.[167] The objective of the corporate income tax regime, the reference system, was the 'taxation of all the profit of all companies subject to tax in Luxembourg', which the contested measure derogated from by leaving profits of some of the Engie group virtually untaxed, which constituted an economic advantage.[168] With no justifications, a selective advantage and thus State aid was found.[169]

The *Engie Decision* further demonstrates issues of uncertainty with the selectivity analysis. The Commission focused on the outcome despite recognising that Engie's treatment arose from two separate non-discriminatory rules.[170] The CJEU has previously rejected outcome-based approaches to the selectivity criterion.[171] Additionally, further criticisms arose from the Commissions intermittent use of market-related benchmarks in the opening decision and the first part of the final decision without developing the benchmark.[172] The Commission's application of the selectivity analysis creates confusion.

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[164] Phedon Nicolaides, 'Can Selectivity Result from the Application of Non-Selective Rules: The Case of Engie' (2019) 18(1) EStAL 15, 16.
[165] *Aid to Engie* (SA 44888) Commission Decision (EU) 2019/421 [2018] OJ L78/1, paras 23-26.
[166] 'Commission finds Luxembourg gave illegal tax benefits to Engie' [2018] EU Focus 23, 24.
[167] *Aid to Engie* (n 165) paras 156-159, 167.
[168] ibid paras 171, 176, 188, 193, 196.
[169] ibid paras 229-230, 235.
[170] Nicolaides (n 164) 17.
[171] ibid 19. See also Cases C-182/03 and C-217/03 *Kingdom of Belgium and Forum 187 ASBL v Commission of the European Communities* [2006] ECR I-05479.
[172] Nicolaides (n 164) 19.

The General Court upheld the Commission's Decision.[173] The Court accepted that Luxembourg's laws usually prevented companies from benefitting from tax deductions twice in respect of the same income.[174] It was further held that Luxembourg's own anti-abuse rules categorised the arrangement as abusive.[175] The contested measure was therefore a selective advantage because rules which were used by default in Luxembourg were derogated from.

3.6 Article 107 as a Reliable and Effective Form of Harmonisation

Undoubtedly, the Commission has been able to use the State aid controls to achieve a far greater degree of direct corporate tax harmonisation than has been possible through the Council due to the requirement that any harmonisation measure achieves unanimous support from all Member States.[176] However, using State aid controls as a means of tax harmonisation is flawed. Primarily, the flaws contribute to either legal uncertainty or ineffectiveness. Consequentially, this limits the ability of Article 107 to tackle the problems arising from each Member State having different corporate tax systems. Article 107's rigid criteria limit its effectiveness. Firstly, the continued reluctance of several Member States to allow any positive harmonisation has led to the Commission interpreting State aid widely.[177] The reluctance of Member States to support positive harmonisation also means that Commission decisions are highly controversial.[178] Measures enacted by the Member States to attract FDI and MNEs who engage in tax avoidance can both be tackled by State aid controls to the extent they meet the Article 107 criteria. Most significantly, that means the measure must be selective. However, while this does limit the number of tax measures that fall within the scope of Article 107, selectivity is seen as a key characteristic that separates general and harmful tax competition. Harmful tax competition measures will therefore fall within the scope of Article 107.

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[173] Case T-516/18 *Grand Duchy of Luxembourg and Others v European Commission* [2021] ECLI-251.
[174] ibid paras 87-91, 340-345.
[175] ibid paras 92-93, 469-473.
[176] Marc Hansen, Anne van Ysendyck and Susanne Zuhlke, 'The coming of age of EC state aid law: a review of the principal developments in 2002 and 2003' (2004) 25(4) ECLR 202, 205.
[177] George Metaxas, 'Tactical target' [2006] Euro Law 30, 30-31.
[178] Jeremy Fleming, 'Give and take' [2006] Euro Law 28, 30-31.

The effectiveness of Article 107 is hampered due to the current focus on using Article 107 to tackle specific rulings and not wider tax systems which result in narrowly applicable rules. This is compounded by the Commission's limited resources, which means that it is only capable of dealing with a fraction of the tips or complaints it receives in relation to potential instances of State aid.[179] Even Member States who wish to comply with State aid rules would not struggle due to the tendency of the Commission to focus on particular tax rules affecting particular MNEs. Inevitably, the narrower the focus of Commission decisions, the narrower the analysis and the narrower the impact of the decisions. An evaluation of the decisions across the four different categories of Commission decisions shows that there is no clear and consistent theme apart from the necessity that tax measures meet Article 107'S State aid requirements to be considered State aid. The current approach, which is to tackle measures deemed to be selective on a 'case-by-case approach', does not properly tackle tax avoidance.[180] The CJEU's judgments should consider whether Member States are able to comply with it.[181] Additionally, the Commission should also consider the ability of Member States to comply with their decisions. The current State aid tax rulings investigations and their subsequent case law are unclear, which leaves Member States with little choice except to disregard the rulings. This is further complicated by the fact that despite there being a positive obligation for Member States to comply with Article 107, the level of compliance varies considerably across Member States.[182] State aid rules in their current form are only able to tackle tax rulings and measures where the contested measures constitute a derogation which creates an advantage for particular undertakings and Article 107 is not, therefore, a tool that can tackle the broader problems which arise from different Member States having different corporate tax systems.[183]

The reference system has also been a source of controversy. Most of the recent Commission decisions on State aid tax rulings have relied on the reference system in the selectivity test being the general corporate income tax system which has the objective of taxing the profits of all companies.[184] The wider system makes it easier for the Commission to identify derogations and the General Court annulling many recent Commission decisions on tax rulings, the use of a wide reference framework has been endorsed by the Court. Tax rules

[179] Ulrich Soltész, 'Commission dreams of hybrid creatures: new tools under the White Paper on foreign subsidies' (2020) 41(12) ECLR 609, 612.
[180] Vats (n 8) 83.
[181] Nicolaides, 'The Definition of the Reference Tax System' (n 58).
[182] Caroline Buts, Tony Joris and Marc Jegers, 'State Aid Policy in the EU Member States' (2013) 12(2) EStAL 330, 333.
[183] Lowe (n 82) 913.
[184] ibid 915.

incentivising FDI are usually designed to be general measures without 'specific investment objectives'.[185] Further, an analysis of the LuxLeaks scandal shows that many of the tax schemes were actually attempts to make tax systems more competitive through differentiating more effectively between 'different types' of activities.[186] A derogation from the reference system may be difficult to identify, and changes to the decision of what the reference system should be may give the Commission too much power.

Reference systems are used to identify selectivity in Member States' tax rulings. However, the reference system and other methods used to establish selectivity demonstrate a key flaw of Article 107 since the selectivity analysis relies on comparing the contested measures to the Member States' other measures. A Member State with a very competitive corporate tax rate would not be captured, yet a Member State with a high tax rate could be captured by a small derogation deemed selective. As stated above, the most common choice of reference system is the general corporate income tax system which inevitably makes it harder to find selectivity in Member States who employ many tax measures to attract FDI. This also makes it difficult to construe Article 107 as a harmonisation measure because although it can be used to minimise the difference in treatment within a Member State, it is not designed to minimise the differences across the different Member States.

A further issue with the selectivity criterion is Article 107's apparent inability to establish selectivity where lenient transfer pricing policies advantage entire sectors while being unavailable to other sectors. The CJEU has previously established selectivity where entire sectors or industries have benefitted. In both *Belgium v Commission* and *Commission v Italy*,[187] reductions in tax contributions were selective where the reductions were primarily available to manual workers and women, respectively, which meant that certain sectors benefitted indirectly due to having high proportions of those workers. In the former, the CJEU stressed that measures that advantaged some industries more than others would not necessarily lead to a finding of selectivity where the differences in treatment arose from the system's purpose and reasoning itself and could be justified due to objective differences between the different industries.[188] This judicial reasoning was developed in *Adria-Wien,*

[185] Pierpaolo Rossi-Maccanico, 'State Aid Review of Member States' Measures Relating to Direct Business Taxation' (2004) 3(2) EStAL 229, 236.
[186] Jaeger, 'From Santander to LuxLeaks' (n 60) 356.
[187] Case C-75/97 *Kingdom of Belgium v Commission of the European Communities* [1999] ECR I-03671; Case 203/82 *Commission of the European Communities v Italian Republic* [1983] ECR 02525.
[188] ibid paras 38-39.

where the contested measure offered energy tax rebates for undertakings producing goods.[189] The CJEU confirmed that a measure that affected many undertakings was not necessarily a general measure and also confirmed that a measure would not be selective if it could be justified.[190] The distinction in *Adria-Wien* was not justified and was thus selective.[191]

However, all three cases involved measures that artificially differentiated between sectors either directly or indirectly without the different treatment being consequential to the logic of the scheme. For instance, a measure that reduces the tax contributions of employers would inevitably benefit labour intensive undertakings more. Likewise, a measure that provided all undertakings with energy tax rebates would advantage some undertakings more. Importantly, however, the differences would derive from the logic of the scheme. The differences are therefore unlikely to be considered selective since if the selectivity criterion could be satisfied in those circumstances simply because some undertakings benefit more than others, Member States would struggle to introduce any measures.

In the context of tax rulings, this difference addresses criticisms that profit allocation practices are often not selective. Transfer pricing and, more importantly, transfer mispricing is facilitated by some Member States. Member States such as Ireland issue advanced pricing agreements that endorse the transfer pricing strategies of undertakings. Transfer pricing is only available to certain undertakings. However, for Ireland to issue an analogous measure to the aforementioned measures deemed selective, it would have to allow transfer mispricing or certain transfer pricing techniques only for certain industries such as the technology industry. In practice, Member States such as Ireland do not differentiate between undertakings or sectors and their transfer pricing policies largely treat all transfer pricing similarly. The current practices are therefore analogous to the hypothetical measure which offers reduced employer contributions to all undertakings. Therefore, the fact that lenient transfer pricing policies create differences between corporations depending on the extent to which they use transfer pricing does not give rise to selectivity.

The Commission has faced multiple defeats at the General Court, which has created legal uncertainty and subsequently has hindered Article 107's effectiveness. The Commission's numerous defeats at the General Court both demonstrates the difficulties of applying Article 107 to tax situations and act as a key factor limiting the applicability and effectiveness of Article 107. As has been outlined throughout this chapter, the Commission often errs in its

[189] Case C-143/99 *Adria-Wien Pipeline GmbH and Wietersdorfer & Peggauer Zementwerke GmbH v Finanzlandesdirektion für Kärnten* [2001] ECR I-08365.
[190] ibid paras 42, 48.
[191] ibid paras 52-53.

analysis of the individual tax rulings and the corporate tax systems of Member States. The Commission has the burden of proof in State aid cases except for the justification step in the selectivity analysis. The Commission must analyse highly complex tax rulings, which in some cases are decades old. This is further complicated by the CJEU prohibiting the Commission from using information that was not available at the time of the tax ruling in their analysis.[192] Since the Member States and MNEs are both willing participants, they may not carry out extensive analyses. The Commission will therefore struggle to demonstrate to the requisite legal standard that Article 107 requirements were met. The Commission's poor performance at the General Court means that their decisions are less influential, and neither the Member States nor the MNEs are likely to change their behaviour in response to the rulings.

In particular, the Commission has faced defeats due to its conflation of economic advantages and selectivity. The Commission has relied on the presumption that economic advantage is selective when applying State aid controls to tax rulings, which is controversial due to the cumulative nature of Article 107's requirements, the 'explicit sovereignty' of Member States in the field of corporate taxes and the ease at which the other Article 107 requirements are met.[193] Discussion of the reference system in the context of the concept of an advantage for individual transfer price rulings is a logical step that recognises that the rulings are more suited to in-depth analysis of advantages rather than in-depth analysis of selectivity.[194] Indeed, tax rulings are specific to individual MNEs and are often also specific to particular financial structures outlined by the relevant tax advisor, which makes assessing selectivity difficult.[195] However, the selectivity criterion is often the deciding factor in State aid investigations into tax rulings. Therefore, the overreliance on the existence of economic advantages rather than selectivity is especially criticised in relation to both the *Starbucks* and *Fiat* decisions.[196] In these decisions, the Commission did not respect the autonomy of the selectivity criterion and reasoned that the reduction of the respective subsidiaries' tax

[192] Case T-760/15 *Netherlands v Commission* [2019] ECLI-669, paras 243-251, 467, 486-487.
[193] Liza Lovdahl Gormsen, 'EU State Aid Law and Transfer Pricing: A Critical Introduction to a New Saga' (2016) 7(6) JECL & Pract 369, 374-375.
[194] Christopher Bobby, 'A Method inside the Madness: Understanding the European Union State Aid and Taxation Rulings' (2017) 18 Chi J Int'l L 186, 209.
[195] Richard Lyal, 'Transfer Pricing Rules and State Aid' (2015) 38 Fordham Int'l LJ 1017, 1042.
[196] Saturnina Moreno Gonzalez, 'State Aid and Tax Competition: Comments on the European Commission's Decisions on Transfer Pricing Rulings' (2016) 15(4) EStAL 556, 565; Spencer A Lee, 'Cutting Ties: Examining the Social, Economic, and Political Implications of Inconsistent European Union State Aid Interpretations on Multinational businesses' (2017) 52 Wake Forest L Rev 713, 722.

liabilities in each case evidenced both an advantage and a derogation.[197] The Commission thereby merged their reasonings for two separate aspects of the State aid test.

The Commission has been accused of undermining legitimate expectations and consequentially legal certainty. Legitimate expectations are part of legal certainty which is a fundamental principle of EU law and an essential component to the rule of law.[198] They represent another tension that arises when State aid rules are applied to Member States' national tax rulings.[199] The Commission has changed the focus of their State aid investigations. Legal certainty means that taxpayers must have been able to legitimately expect their tax agreements would have contravened State aid controls at the time they were concluded.[200] The standard for a legitimate expectation is a 'diligent businessman'.[201] Member States have sovereignty over direct corporate tax, which means a diligent businessman may believe that a Member States' tax administration who enters into an advanced pricing agreement with their company understands the legality of the agreement and if at the time of the agreement, the Commission did not pursue individual tax rulings of a similar nature then a diligent businessman may not foresee the illegality of the agreement. For these reasons, MNEs who have consulted the tax administration in the respective Member State arguably have a 'legitimate expectation' that they can rely on the advanced rulings to be lawful in some circumstances.[202]

Uncertainty can also lead to increased compliance costs, an issue discussed in Chapter One. Legal uncertainty may lead to increased consultancy and litigation costs.[203] Decisions that undermine the predictability of investing in the EU or in individual Member States will also reduce the incentive to invest in the EU.[204] For example, while the application of State aid controls to Member States' national tax measures is nothing new, the focus of recent

[197] Iliopoulos (n 113) 268-269.
[198] Liza Lovdahl Gormsen and Clement Mifsud-Bonnici, 'Legitimate Expectation of Consistent Interpretation of EU State Aid Law: Recovery in State Aid Cases Involving Advanced Pricing Agreements on Tax' (2017) 8(7) JECL & Pract 423, 425, 433.
[199] Pierpaolo Rossi-Maccanico, 'State Aid Review of Business Tax Measures' (2007) 6(2) EStAL 215, 228.
[200] Gormsen and Mifsud-Bonnici (n 198) 423, 433.
[201] ibid.
[202] Marie-Helene Polo, 'The reimbursement of state aid in the EU' (1995) 1(6) Int TLR 199, 199.
[203] Gormsen and Mifsud-Bonnici (n 198) 423, 434.
[204] Katlynn Michalski, 'Equalizing or Encroaching - Ireland's Place in the European Commission's Move toward Tax Harmony' (2018) 35 Wis Int'l LJ 704, 737.

investigations on the 'selective application' of 'general rules' in favour of MNEs is new.[205] However, it has rightly been highlighted that the uncertainty predominantly affects tax schemes and tax rulings that involve the 'objectionable practice' of 'unduly' reducing tax liability and that these practices should be made less attractive.[206] Moreover, it has also been highlighted that the decisions do not 'annihilate certainty' and instead act as a mere reminder to taxpayers of the limits of tax rulings.[207]

Article 107 suffers from many of the same flaws as the four freedoms case law. It is less effective than the four freedoms case law at harmonising corporate taxes and overcoming the problems outlined in Chapter One. Article 107's rigid criteria have a more restrictive effect and Article 107 also lacks a harmonising element. As has previously been discussed, Article 107 establishes whether State aid exists by analysing the contested measure in relation to the Member States' other tax measures. This means that State aid is unable to harmonise laws between different Member States and can only ensure that tax rulings are not used to give particular undertakings within a Member States territory a selective advantage over other undertakings in the same territory. The four freedoms are designed to protect MNEs' and Member States must not contravene MNEs' four freedoms. The resulting harmonisation is far from ideal and is considered chaotic by many. However, despite their very purpose being to protect MNEs, the four freedoms case law has helped to counteract and tackle the problems outlined in Chapter One. The CJEU has recognised the problems and has negotiated a careful balance between the competing needs of Member States and MNEs. Likewise, despite its flaws, Article 107 can tackle some of the problems identified in Chapter One. Article 107 limits the tax competition options for Member States by making it harder for Member States to introduce selective measures. This reduces the likelihood of tax-avoiding MNEs receiving a competitive advantage over close direct competitors as Article 107 mandates general measures. This, therefore, reduces some of the negative effects of tax avoidance. However, the flaws of both Article 107 and the four freedoms case law prove that positive harmonisation is essential to fully tackle the problems in Chapter One.

[205] Edoardo Traversa and Alessandra Flamini, 'Fighting Harmful Tax Competition through EU State Aid Law: Will the Hardening of Soft Law Suffice' (2015) 14(3) EStAL 323, 323-324.
[206] Colino (n 122) 461.
[207] ibid 460.

Chapter 4: Positive Harmonisation as a Solution to Corporate Tax Problems

4.1 Introduction

Positive corporate tax harmonisation measures provide an alternative to negative harmonisation. The last substantive chapter explores positive harmonisation measures in three main parts. All measures must adhere to three principles. Firstly, the principle of subsidiarity must be followed when the EU does not have exclusive competence which ensures that the EU only adopts measures when 'it is better to do so' and ensures measures do not exceed 'the aims set' in the treaties.[1] Secondly, the principle of proportionality as defined in *ex parte Fedesa* determines the design of harmonisation measures and consists of three tests, suitability and necessity as laid out in *ex parte Fedesa* and proportionality *stricto sensu*.[2] Thirdly, the principle of conferral requires the EU to act within the limits of the EU's competences.[3] The EU may only act in areas where Member States have conferred competences on the EU.[4] When the Member States have not, those competences remain with the Member States.[5] The EU institutions must act within the limits of its powers which have been conferred on them by the Member States.[6] This chapter will analyse the possible legal base of any measures needed for the principle of conferral in detail. This chapter then analyses the developing positive harmonisation analysis by identifying and evaluating past harmonisation. Finally, this chapter considers the present and future harmonisation. The 2016 CCCTB proposals will then be analysed to determine whether they would resolve the

[1] Consolidated version of the Treaty on European Union (TEU) [2016] OJ C202/18, art 5(3); Consolidated version of the Treaty on the Functioning of the European Union (TFEU) [2016] OJ C202/1, art 3; Jacobien W Rutgers, 'European Competence and a European Civil Code, a Common Frame of Reference or an Optional Instrument' in Arthur S Hartkamp and others (eds), *Towards a European Civil Code* (fourth edition, Kluwer Law International 2010) 314.
[2] Aurelien Portuese, 'Principle of Proportionality as Principle of Economic Efficiency' (2013) 19(5) Eur Law J 612, 617; Augustin Fuerea, 'Brief Considerations On The Principles Specific To The Implementation Of The European Union Law' (2014) XXI(1) Lex et Scientia 49, 51; Tor-Inge Harbo, 'The Function of the Proportionality Principle in EU Law' (2010) 16(2) Eur Law J 158, 165.
[3] Consolidated Version of the Treaty on European Union (TEU) [2008] OJ C115/13, art 5.
[4] ibid art 5(2).
[5] ibid art 4.
[6] ibid art 13.

problems outlined in Chapter One, and the proposals will be compared to the negative harmonisation discussed in Chapters Two and Three. This chapter will also evaluate some of the alternative harmonisation measures the Commission may want to consider. Chapter Four will conclude by evaluating whether positive harmonisation is the most effective solution to the problems outlined in Chapter One.

4.2 The Positive Harmonisation Framework

4.2.1 The Competences – Determining the Correct Legal Base

4.2.1.1 The Correct Competence for Corporate Tax Harmonisation

Article 114 provides the EU with the power to act 'for the approximation of the provisions laid down by law … which have as their object the establishment and functioning of the internal market'.[7] Directives, regulations and decisions are all possible under Article 114,[8] so long as four requirements are met. Firstly, there must be no specific legal basis since other legal bases may have more stringent legislative processes. For example, some legal bases require unanimous approval.[9] Secondly, measures must be introduced to harmonise, either fully or partially, national laws.[10] Thirdly, fiscal harmonisation cannot rely on Article 114 and can therefore generally not be used for corporate tax harmonisation.[11] As, measures may have multiple purposes where the correct legal basis will be decided according to the primary purpose of the measure,[12] determined via the centre of gravity doctrine.[13] Finally, as per *Tobacco Advertising,* the lack of harmonisation must be detrimental to the internal

[7] TFEU [2016], art 114(1).
[8] Rutgers (n 1) 316.
[9] Manuel Kellerbauer, 'Part Three: Title VII Rules on Competition, Taxation & Approximation of Laws, Chapter Three: Approximation of Laws' in Manuel Kellerbauer, Marcus Klamert and Jonathan Tomkin (eds), *The EU Treaties and the Charter of Fundamental Rights* (OUP 2019) 1241.
[10] TFEU [2016], art 114; Kellerbauer (n 9) 1237-1238.
[11] TFEU [2016], art 114 (2).
[12] Case C-155/91 *Commission of the European Communities v Council of the European Communities* [1993] ECR I-939.
[13] Geert De Baere and Tina Van den Sanden, 'Interinstitutional Gravity and Pirates of the Parliament on Stranger Tides: the Continued Constitutional Significance of the Choice of Legal Basis in Post-Lisbon External Action' (2016) 12 EuConst 85, 89ff.

market.[14] Article 114 is not therefore a 'general power to regulate the economy'.[15] Nevertheless, despite clear limits and safeguards, Article 114 has 'contributed to the expansion of the EU's competences'.[16]

Article 352 does not require the approximation of laws, and its purpose is to allow the EU to introduce measures in areas in which the treaties did not foresee EU action. Such flexibility is countered by the unanimity requirement.[17] The European Parliament's consent is also required.[18] Article 352 can be used when the EU wishes to 'adopt an optional instrument', which is not possible under Article 114.[19] Article 352 has three requirements. The measure must be necessary within the framework of the treaties' policies,[20] and the EU must be unable to act using another power.[21]

Article 116 provides that if the Commission identifies diversification of Member States' national laws, which leads to distortions of competition in the internal market, the Commission may consult those Member States. The CJEU has not interpreted 'distortion of competition', but the Commission has applied a very strict interpretation.[22] Should consultations fail to eliminate distortions, a necessary directive can be issued which resolves the distortions.[23] Article 116 allows these directives to be made according to the ordinary legislative procedure.[24] This means that QMV by the Council will be used.[25] The unanimity requirement is the primary reason behind the lack of successful, positive corporate tax

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[14] Case C-376/98 Federal Republic of Germany v European Parliament and Council of the European Union [2000] ECR I-8419; Kellerbauer (n 9) 1237; Loïc Azoulai, 'Part V Regulation of the Market Place, The Complex Weave of Harmonization' in Damian Chalmers and Anthony Arnull (eds), *The Oxford Handbook of European Union Law* (OUP 2015) 596.
[15] Jukka Snell, 'The Internal Market and the Philosophies of Market Integration' in Catherine Barnard and Steve Peers (eds), *European Union Law* (3rd Edition, OUP 2020) 355.
[16] Malu Beijer, *Limits of Fundamental Rights Protection by the EU* (Intersentia 2017) 187.
[17] TFEU [2016], art 352 (1).
[18] ibid.
[19] Rutgers (n 1) 322.
[20] Manuel Kellerbauer and Marcus Klamert, 'Part Three: Title VII Rules on Competition, Taxation & Approximation of Laws, Chapter Three: Approximation of Laws' in Manuel Kellerbauer, Marcus Klamert and Jonathan Tomkin (eds), *The EU Treaties and the Charter of Fundamental Rights* (OUP 2019) 2074-2075.
[21] ibid 2075-2076.
[22] Kellerbauer (n 9) 1259.
[23] ibid 1260.
[24] ibid 1260.
[25] 'Glossary of summaries' (EUR-Lex) <https://eur-lex.europa.eu/summary/glossary/ordinary_legislative_procedure.html> accessed 22 August 2021.

harmonisation measures. Joachim Englisch describes this as the 'nuclear option'.[26] It cannot be used when distortions 'arise from the parallel application of essentially identical but uncoordinated national tax regimes'.[27] In response to a European parliamentary question, the Commission dismissed Article 116, stating it 'is not a possible legal basis for proposals on tax harmonisation' and that only Articles 113 and 115 TFEU could be used.[28] Article 113 provides a legal basis for indirect tax harmonisation.[29] The proper interpretation of Article 116 is uncertain since the courts have never considered it,[30] and the Commission has never successfully used it.[31] Article 116's use is a *nuclear option* as it would allow the Commission to overrule the will of Member States in politically sensitive areas.[32]

Article 115 also provides for 'the approximation of laws'.[33] Article 114's 'substantive conditions' are 'in essence identical'.[34] It only has practical relevance 'for the harmonisation of direct taxes',[35] using directives.[36] It is the legal basis for corporate tax harmonisation, and according to *Spain v Council*, the Courts are likely to agree.[37] Its special legislative procedure requires unanimity at the Council and that the European Parliament and the European Economic and Social Committee are both consulted.[38] It provides for controversial and sensitive areas to be harmonised if every Member State agrees,[39] ensuring harmonisation in politically sensitive areas is the 'result of political decisions with strong democratic

[26] Joachim Englisch, 'Article 116 TFEU – The Nuclear Option for Qualified Majority Tax Harmonization?' (2020) 29(2) EC Tax Rev 58.
[27] ibid 58.
[28] Mr Moscovici, answer to parliamentary question E-001797/2019 (European Parliament, 27 June 2019) <https://www.europarl.europa.eu/doceo/document/E-8-2019-001797-ASW_EN.html> accessed 22 August 2021.
[29] TFEU [2016], art 113.
[30] Joachim Englisch, 'Article 116 TFEU' (n 26) 59-60.
[31] Kellerbauer (n 9) 1258.
[32] TFEU [2016], art 116.
[33] ibid art 115.
[34] Kellerbauer (n 9) 1257.
[35] ibid 1256.
[36] ibid 1256-1257.
[37] Brady Gordon, 'Tax competition and harmonisation under EU law: economic realities and legal rules' (2014) 39(6) EL Rev 790, 809.
[38] Kellerbauer (n 9) 1257.
[39] ibid 1256; Gordon (n 37) 811; Norbert Herzig and Johannes Kuhr, 'Direct Taxation in the Eu: The Common Corporate Tax Base as the Next Sub-Step towards Harmonization' (2011) 1(2) Wroclaw Review of Law, Administration & Economics 1, 2.

legitimacy'.[40] It protects the sovereignty of Member States in sensitive areas.[41] However, unanimity can make progress difficult.[42] Many Member States design their tax systems to support key industries.[43] Many Member States fear the combined tax base will lead to less FDI and less tax revenue.[44] Ireland and Hungary have vowed to reject harmonisation.[45] For Member States such as Ireland, tax competition is an integral 'part of their economic plan'.[46] Unanimity creates unequal bargaining powers during negotiations.[47] It makes decision making 'slow and inflexible' and means that integration progresses at the rate of the most hesitant Member State.[48]

4.2.1.2 Alternative Avenues for Implementation

The unanimity requirement can be replaced by QMV.[49] QMV is where only 55% of Member States representing at least 65% of the EU population need to support a measure at the Council vote.[50] Under QMV, a blocking minority comprising of at least four Member States and representing at least 36% of the population can stop a measure.[51] While QMV is widely used sensitive areas still rely on unanimity.[52] QMV must be used except where the treaties

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[40] Agustín José Menéndez, 'Neumark vindicated: the three patterns of Europeanisation of national tax systems and the future of the social and democratic Rechtsstaat' in Damian Chalmers, Markus Jachtenfuchs and Christian Joerges (eds), *The End of the Eurocrats' Dream, Adjusting to European Diversity* (CUP 2016) 81.
[41] George Tsebelis, 'Bridging qualified majority and unanimity decision making in the EU' (2013) 20(8) J Eur Public Policy 1083, 1089.
[42] ibid.
[43] Richard Tromans, 'The impossible dream?' (2006) 62 Euro Law 55, 56.
[44] Antonio Martins, 'The Portuguese corporate tax reform and international trends: an assessment' (2015) 57(4) Int JLM 281, 287.
[45] 'Ireland and Hungary reject EU-wide tax harmonisation moves' *Euronews* (Hungary, 4 January 2018) <https://www.euronews.com/2018/01/04/ireland-and-hungary-reject-eu-wide-tax-harmonisation-moves> accessed 22 August 2021.
[46] Philip Gillett, 'Transfer pricing disputes in the European Union' in Eduardo Baistrocchi and Ian Roxan (eds), *Resolving Transfer Pricing Disputes, A Global Analysis* (CUP 2012) 184.
[47] Joseph Jupille, 'The European Union and international outcomes' (1999) 53(2) International Organization 409, 411.
[48] Erik Berglöf and others, 'Club-in-the-club: Reform under unanimity' (2012) 40(3) Journal of Comparative Economics 492, 493.
[49] 'Commission launches debate on gradual transition to majority voting in EU tax policy' [2019] EU Focus 1, 2.
[50] European Council, 'Qualified majority' (Consilium) <https://www.consilium.europa.eu/en/council-eu/voting-system/qualified-majority/> accessed 23 August 2021.
[51] ibid.
[52] Neill Nugent, 'Enlargements and Their Impact on EU Governance and Decision-Making' (2015) 12(1) Journal of Contemporary European Research 424, 426-427.

have stipulated that other procedures must be used.[53] The Commission agrees that the unanimity requirement is unsuitable for an enlarged EU.[54] QMV would allow Member States to address shared challenges relating to their already pooled sovereignty more efficiently.[55] The Commission's proposal to move towards QMV and away from unanimity consists of four steps and extends to multiple areas other than corporate tax harmonisation.[56] However, the unanimity requirement of transitioning to QMV means that it is not a realistic option.

Alternatively, enhanced cooperation is an avenue for harmonisation when the political support required for unanimity does not exist.[57] It can act as a pragmatic response to the political reality surrounding the implementation of harmonisation measures.[58] It provides a way forward when some Member States do not wish to participate since only the unanimous approval of the participating Member States is required,[59] thus facilitating integration where a subset of Member States reaches a consensus.[60] The European Economic and Social Committee has said that it 'could endorse' its use.[61] However it 'is a cumbersome process' and not necessarily an easy option.[62] Enhanced cooperation must enhance the objectives of the European Union.[63] It must remain open to all Member States.[64] However, there are

[53] Sigrid Boysen and Moritz von Unge, 'Regulating EU Climate and Energy Matters through Conclusions: The Limits of Consensus' (2015) 12(2) Journal for European Environmental and Planning Law 128, 151; TEU [2008], art 16.
[54] Commission, 'Towards a more efficient and democratic decision making in EU tax policy' (Communication) COM (2019) 8 final.
[55] 'Commission launches debate' (n 49) 1.
[56] ibid 2.
[57] TEU [2008], art 20; TFEU [2016], arts 326-34; Anno Rainer, Otmar Thoemmes and Eric Tomsett, 'European Commission suggests common consolidated tax base' (2004) 15(10) International Tax Review 36.
[58] Daniel Thym, ' The political character of supranational differentiation' (2006) 31(6) EL Rev 781, 788-89.
[59] ibid; Christiana HJI Panayi, 'Reverse subsidiarity and EU tax law: can Member States be left to their own devices?' [2010] BTR 267, 275.
[60] Jens Brøchner, 'The Dilemmas of Tax Coordination in the Enlarged European Union' (2008) 53(4) CESifo Econ Stud 561, 571.
[61] Commission, 'Opinion of the European Economic and Social Committee on the 'Communication of the Commission to the Council, the European Parliament and European Economic and Social Committee: An internal market without company tax obstacles – achievements, ongoing initiatives and remaining challenges' (Opinion) COM(2003) 726 final, para 3.9.
[62] Annette Schrauwen, 'Sources of EU Law for Integration in Taxation' in Dennis Weber (Ed) *Traditional and Alternative Routes to European Tax Integration* (IBFD 2010) 24.
[63] TEU [2008], art 20; Daniela A Kroll and Dirk Leuffen 'Enhanced cooperation in practice. An analysis of differentiated integration in EU secondary law' (2015) 22(3) Journal of European Public Policy 353, 354.
[64] Kroll and Leuffen (n 63).

concerns that side-stepping the unanimity requirement champions a 'two-speed Europe'.[65] At least nine Member States must request permission from the Commission, which may only take place after other forms of integration have been attempted.[66]

4.3 Past Positive Harmonisation Measures in the EU

4.3.1 Early Pro-Harmonisation Support

Early studies 'looked favourably on the harmonisation of income taxes'.[67] The Neumark Report recognised that 'unification' was politically impossible, so advocated for 'harmonisation'.[68] The EU only managed the first stage of the report, turnover tax reform.[69] The Segrè Report advocated for a 'neutral' tax system.[70] However, the recommendations were not implemented.[71] The 1969 programme for harmonisation proposed 'the harmonisation of tax rates', 'removal of tax obstacles to cross-border corporate restructurings' and 'the elimination of double taxation in parent-subsidiary relationships' among others.[72] This was followed by the Van Tempel Report, which had 'a clear pro-harmonisation bias'.[73] Tax harmonisation remained supported by the Commission and, in fact, became even more of a necessity as it was needed 'to accompany … [the] economic and monetary union'.[74]

4.3.2 A Change in Strategy

The Commission soon endorsed a 'minimalistic approach' where a combination of struggling to find a consensus and struggling to achieve unanimity pushed the Commission

[65] Massimo Bordignon and Sandro Brusco, 'On enhanced cooperation' (2006) 90(10-11) Journal of Public Economics 2063.
[66] Kroll and Leuffen (n 63).
[67] Franco Gallo, 'Tax Harmonisation' in Giuliano Amato and others (eds), *The History of the European Union: Constructing Utopia* (Hart Publishing 2019) 286.
[68] Christiana Hji Panayi, 'The Early Proposals for a European Corporate Tax Policy' in Peter Harris and Dominic de Cogan (eds), *Studies in the History of Tax Law* (Hart Publishing 2019) 369, 368.
[69] ibid 372, 373.
[70] ibid 373.
[71] ibid 374.
[72] ibid 375.
[73] ibid.
[74] ibid 376.

to consider more limited measures.[75] These measures were centred around removing barriers to intra-EU trade.[76] The 1975 Action Programme for Taxation was a catalyst for the change in policy direction.[77] The Commission proposed, among others, a 'directive on harmonising corporate tax systems' which failed to garner the support of the European Parliament who 'wanted to harmonise the corporate tax base as well'.[78] Following this, the Commission changed its policy direction to focus on 'targeted solutions', pushing for 'more coordination' as opposed to wide-reaching directives.[79] The period which followed consisted of different 'non cohesive' measures.[80]

In 1990, the Commission changed its focus to harmonising specific areas for the purposes of ending double taxation.[81] The Commission listed several priority measures which would be necessary to eliminate double taxation,[82] three of these were adopted by the Council with unanimous support.[83] Member States had not previously agreed on corporate tax measures.[84] The first priority was addressed by the Parent-Subsidiary Directive.[85] This would assist 'the operation of a foreign subsidiary'.[86] The 1990 Parent-Subsidiary Directive was subsequently strengthened and developed by a 2003 Directive.[87] The subsequent directive expanded the

[75] Menéndez (n 40) 87-88.
[76] Leon Bettendorf and others, 'Corporate tax harmonization in the EU [with Discussion]' (2010) 25(63) Economic Policy 537, 542.
[77] Commission, 'Action Programme for Taxation' (Communication) COM (75) 391 final; Panayi, 'The Early Proposal' (n 68) 379.
[78] Panayi, 'The Early Proposal' (n 68) 378.
[79] ibid 379.
[80] Gallo (n 67) 285.
[81] Commission, 'Renewed Progress on the Issue of Company Taxation' (Press Release 23 November 1992) IP/92/940 <https://ec.europa.eu/commission/presscorner/detail/en/IP_92_940> accessed 22 August 2021.
[82] ibid.
[83] Michael Devereux, 'The Ruding Committee Report: An Economic Assessment' (1992) 13(2) Fiscal Studies 96, 97.
[84] Jan E Brinkmann and Andreas O Riecker, 'European Company Taxation: The Ruding Committee Report Gives Harmonization Efforts a New Impetus' (1993) 27(4) The International Lawyer 1061, 1065.
[85] Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States [1990] OJ L225/6.
[86] Alex Easson, 'Harmonization of Direct Taxation in the European Community: From Neumark to Ruding' (1992) 40 Can Tax J 600, 613.
[87] Council Directive 2003/123/EC of 22 December 2003 amending Directive 90/435/EEC on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States [2003] OJ L7/41.

scope, tackled double taxation concerning subsidiaries and relaxed specific conditions relating to withholding tax dividends.[88]

The next priority was addressed by the Merger Directive, which eliminated certain double taxation in merger situations.[89] It took over twenty-one years for the Commission's proposal to be adopted by the Council despite its 'modest scope'.[90] It was strengthened by a subsequent directive in 2005, which broadened the scope of the directive to include a greater number of legal entities.[91] Both directives were codified into one in 2009.[92] Since the first two priorities were addressed, no income tax directive has gained the unanimous support required at Council despite 'hundreds' of other directives being passed.[93] The belief that a focus on minimalistic measures would assist in progress being made was therefore proven wrong.[94]

The final priority was addressed by the Arbitration Convention, which sought to address double taxation arising from transfer pricing adjustments.[95] The Arbitration Convention did not attempt to resolve ongoing disputes relating to the transfer pricing methods which should be used when regulating transfer pricing arrangements.[96] It was implemented as a convention and later extended with minor amendments in 1999.[97] The protocol was ratified in 2004 and

[88] ibid see expanding the scope para 4, double taxation para 10 and withholding taxes para 2.
[89] Council Directive 90/434/EEC of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States [1990] OJ L225/1.
[90] Easson (n 86) 611.
[91] Council Directive 2005/19/EC of 17 February 2005 amending Directive 90/434/EEC 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States [2005] OJ L58/19, paras 10-12.
[92] Council Directive 2009/133/EC of 19 October 2009 on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States and to the transfer of the registered office of an SE or SCE between Member States [2009] OJ L310/34.
[93] Frans Vanistendael, 'The Making or Br(e)aking of Europe or the Challenges for a European Tax Policy' (2000) 1 EBOR 109, 114.
[94] Menéndez (n 40) 88.
[95] Convention 90/436/EEC of 20 August 1990 on the elimination of double taxation in connection with the adjustment of profits of associated enterprises [1990] OJ L225/10.
[96] Stephen Bond and others, 'Corporate tax harmonisation in Europe: a guide to the debate' (2000) Institute for Fiscal Studies Report, 66 <https://ifs.org.uk/comms/r63.pdf> accessed 10th August 10, 2021.
[97] Protocol of 16 July 1999 amending the Convention of 23 July 1990 on the elimination of double taxation in connection with the adjustment of profits of associated enterprises [1999] OJ C202/01.

given ‘retroactive effect’ from 2000.[98] Attempts to improve the Arbitration Convention and transform it into ‘a working reality’ were made by the Commission in 2002 when they created the Joint Transfer Pricing Forum.[99] The Forum provides ‘non-legislative solutions’.[100] In response to the Council’s willingness to pass the first two priorities, the Commission submitted two new proposals, which were also both aimed at tackling double taxation.[101] The first proposal would concern withholding taxes, and the second would concern cross border loss deductions.[102]

The Ruding Committee Report explored the issues affecting the economy,[103] which arise from the different tax rates in the EU and explored the potential solutions.[104] The report found that distortions existed and recommended minimum tax rates and increased transparency,[105] despite acknowledging that it would constitute a significant reduction in the sovereignty of Member States.[106] The recommendations can be considered a ‘confirmation’ that past proposals ‘were right all along’.[107]

The Commission developed another tax package which included a savings directive, an interest and royalties directive and a code of conduct.[108] The code of conduct was a political

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[98] EU Joint Transfer Pricing Forum, ‘Report on the Re-Entry Into Force of the Arbitration Convention’ (European Commission, 30 May 2005) <https://ec.europa.eu/taxation_customs/system/files/2016-09/report_jtpf_en.pdf> accessed 22 August 2021; ‘Transfer Pricing and the Arbitration Convention’ (European Commission) <https://ec.europa.eu/taxation_customs/transfer-pricing-and-arbitration-convention_en> accessed 22 August 2021.
[99] Gillett (n 46) 170; ‘Joint Transfer Pricing Forum’ (European Commission) <https://ec.europa.eu/taxation_customs/joint-transfer-pricing-forum_en> accessed 22 August 2021.
[100] Transfer Pricing Forum (n 99).
[101] Brinkmann and Riecker (n 82) 1066.
[102] Commission, ‘Proposal for a Council Directive on a common system of taxation applicable to interest and royalty payments made between parent companies and subsidiaries in different Member States’ COM (90) 571 final; Commission, ‘Proposal for a Council Directive Concerning Arrangements for the Taking Into Account by Enterprises of the Losses of their Permanent Establishments and Subsidiaries Situated in Other Member States’ COM (90) 595 final.
[103] Commission, ‘Report of the Committee of Independent Experts on Company Taxation’ (March 1992) <https://op.europa.eu/en/publication-detail/-/publication/0044caf0-58ff-4be6-bc06-be2af6610870> accessed 23 August 2021.
[104] ibid 11.
[105] ibid 13; Malcolm Gammie, ‘The Harmonisation of Corporate Income Taxes in Europe: The Ruding Committee Report’ (1992) 13(2) Fiscal Studies 108, 119; Bond and others (n 96) 67.
[106] Brinkmann and Riecker (n 84) 1073.
[107] Easson (n 86) 632.
[108] Commission, ‘Ecofin reaches political agreement on taxation: "an historic breakthrough" says Commissioner Monti’ (Press Release, 2 December 1997)

agreement by the Member States.[109] It was a 'reaction' to the lack of harmonisation caused by the unanimity requirement.[110] The Lisbon strategy committed Member States to transform the internal market into 'the most competitive and dynamic… in the world'.[111] It requires a degree of tax harmonisation to address existing obstacles and improve efficiency.[112] In 1998 the Ecofin Council asked the Commission to undertake an 'analytical study on company taxation', which was published in 2001.[113] The report maintained that the lacklustre effects of previous directives were partially due to 'the different ways' they were implemented across the EU and future progress should therefore focus on cooperation.[114] The report reiterated the need for increased cooperation and coordination when it assessed the failures of the Arbitration Convention.[115]

Mutual recognition for corporate taxation was another unsuccessful harmonisation attempt.[116] It 'provides that the rules of one Member State are recognised in all other Member States'.[117] Home State Taxation envisioned that SMEs would have their taxable profits calculated 'according to the tax rules of the [parent companies'] home state'.[118]

4.3.3 Recent developments

The merits of a combined tax base have increasingly been recognised by the EU. In 1988, the Commission drafted a proposal for harmonising corporate tax bases although this was

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<https://ec.europa.eu/commission/presscorner/detail/en/IP_97_1067> accessed 23 August 2021.

[109] European Council, 'Code of Conduct Group (Business Taxation)' (Consilium) <https://www.consilium.europa.eu/en/council-eu/preparatory-bodies/code-conduct-group/> 23 August 2021.

[110] Hans Gribnau 'The Code of Conduct for Business Taxation: An Evaluation of an EU Soft-Law Instrument in Dennis Weber (Ed) *Traditional and Alternative Routes to European Tax Integration* (IBFD 2010) 68.

[111] European Council, 'Presidency Conclusions of European Council on 23-24 March 2000' para 5 <https://www.consilium.europa.eu/ueDocs/cms_Data/docs/pressData/en/ec/00100-r1.en0.htm> accessed 23 August 2021.

[112] ibid para 26ff.

[113] Gillett (n 46) 165; Commission, 'Staff Working Paper: Company Taxation in the Internal Market' (Working Paper) COM (2001) 582 final.

[114] Gillett (n 46) 169.

[115] ibid.

[116] Commission, 'Tackling the corporation tax obstacles of small and medium-sized enterprises in the Internal Market – outline of a possible Home State Taxation pilot scheme […]' (Communication) COM (2005) 702 final.

[117] Guglielmo Maisto 'Taxation of Groups and CCCTB' in Ana Paula Dourado (Ed) *Movement of Persons and Tax Mobility in the EU: Changing Winds* (IBFD 2013) 357.

[118] ibid.

never voted on.[119] The Commission's reliance on 'coordination of social and fiscal policies' existed until the 2000s'.[120] A 'common harmonised tax base' was considered 'the most desirable way forward' by most Member States in 2004.[121] The Commission proposed a combined tax base in 2011.[122] Member States would set their own corporate tax rates, which would ensure their sovereignty was safeguarded upon implementation of the proposal.[123] The proposal would have introduced uniform rules governing all cross-border EU companies who chose to opt-in.[124] The 2001 company taxation report advocated for a combined tax base believing that it would be a 'comprehensive solution' to the problems it identified.[125] When the 2011 proposal was introduced, it was argued that politics would determine its fate.[126]

The EU adopted an anti-tax avoidance package in 2016,[127] which included the Anti-tax Avoidance Directive.[128] No other directive's scope has been as wide.[129] However, its success does not necessarily demonstrate a change in attitude towards harmonisation as it is targeted towards tackling tax avoidance. Its implementation can be differentiated from other forms of harmonisation since it was in response to the OECD's BEPs action plan.[130] Over '139 countries and jurisdictions' are signatories of the OECD/G20 Inclusive Framework on BEPs, and many Member States would have implemented similar changes regardless.[131]

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[119] Inga Chelyadina, 'Harmonization of Corporate Tax Base in the EU: An Idea Whose Time Has Come?' (2019) Bruges Political Research Papers 76/2019, 1, 7-8 <https://www.coleurope.eu/research-paper/harmonization-corporate-tax-base-eu-idea-whose-time-has-come> accessed 23 August 2021.
[120] Gallo (n 67) 286.
[121] Bettendorf and others, 'Corporate tax harmonization' (n 76).
[122] Commission, 'Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB)' COM (2011) 121 final.
[123] Adina Trandafir, 'Common Consolidated Corporate Tax Base, a New Measure to Remove Tax Competition Distortions in the EU' (2011) 14(1) Economy Transdisciplinarity Cognition 310; Bettendorf and others, 'Corporate tax harmonization' (n 76) 543.
[124] CCCTB (2011) (n 122), 6.
[125] Gillett (n 46) 169.
[126] ibid 184.
[127] Katerina Pantazatou, 'The Evolution of Direct Taxation in the EU: A Multi-Variable Equation' in Lucila de Almeida and others (eds), *The Transformation of Economic Law: Essays in Honour of Hans-W Micklitz* (Hart Publishing 2019) 187.
[128] Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market [2016] OJ L193/1.
[129] Pantazatou (n 127) 190.
[130] OECD, 'Action Plan on Base Erosion and Profit Shifting' (OECD Publishing, 2013), <http://dx.doi.org/10.1787/9789264202719-en> accessed 23 August 2021.
[131] OECD, 'International collaboration to end tax avoidance' (OECD) <https://www.oecd.org/tax/beps/> accessed 23 August 2021; OECD, 'European Union and

4.3.4 Conclusion

The different successes of the different corporate tax harmonisation reports and proposals demonstrate that the more 'limited proposals' have always been 'easier to push through'.[132] To date, the most far-reaching directive, the ATAD directive, is narrowly focused on anti-tax avoidance. Political will for corporate tax harmonisation has always existed, especially in EU institutions such as the Commission. The range of past measures also suggests that evidence of the potential benefits of the 2016 proposals may be insufficient to persuade all Member States to support it. The unanimity requirement has rendered past directives 'inevitably imperfect' due to the 'bargaining process' associated with any corporate tax measure's implementation.[133]

4.4 2016 Proposal(s)

The Commission's 2016 proposals are their latest positive harmonisation measure, and their successful implementation is a high priority for the Commission.[134] They are centred around tackling tax avoidance.[135]

4.4.1 Main Characteristics of the 2016 Proposals

The proposals are mandatory for groups exceeding a €750 million yearly turnover. The threshold will withstand scrutiny so long as it was not chosen for discriminatory effects.[136] It is logical to offer MNEs below a certain size the choice since the scheme could prove burdensome for smaller companies. Defending the exact size and justifying it in relation to similar sizes, either just above or just below, would be too burdensome.[137] Large MNEs are

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the OECD' (OECD) <https://www.oecd.org/eu/european-union-and-oecd.htm> accessed 23 August 2021.

[132] Panayi, 'The Early Proposal' (n 68) 375.

[133] Georg Kofler and Mario Tenore, 'Fundamental Freedoms and Directives in the Area of Direct Taxation' in Dennis Weber (Ed) *Traditional and Alternative Routes to European Tax Integration* (IBFD 2010) 323.

[134] Christiana HJI Panayi, *European Union Corporate Tax Law* (2nd edn, CUP 2021) 88.

[135] ibid.

[136] Ruth Mason and Leopoldo Parada, 'Company Size Matters' [2019] BTR 610, 640.

[137] ibid.

most able to exploit the differences between tax systems to avoid tax and Member States who engage in tax competition aim to attract larger MNEs.[138]

Furthermore, the increasing prevalence of debt shifting via excessive interest payments caused by the asymmetrical treatment of debt and equity is recognised by the proposals.[139] The first rule limits the deductibility of interest costs by allowing group companies to deduct their financial costs only to the amount of their financial revenues.[140] The second rule makes increases in taxpayers equity deductible from the taxpayers' taxable base under certain conditions.[141] Together, they make the treatment of debt and equity more symmetrical.[142] This reduces the incentive for MNEs to become overly indebted and shift their debt to high tax Member States.[143]

Moreover, the proposals tackle tax avoidance involving third countries through the controlled foreign company (CFC) rule and the switch-over clause. The proposals are broadly based on the ATAD's CFC rules and will reattribute income from subsidiaries in low taxed jurisdictions to the MNE within the EU.[144] The switch-over clause targets particular income from third countries,[145] and tax them in the EU if they have been taxed below a particular level in the third country.[146] This helps to avoid double non-taxation by ensuring that certain income is taxed so long as it was not taxed or was taxed below a certain amount.[147]

Additionally, the combined tax base removes the need for intra-EU exit taxation.[148] Chapter Two analysed how the CJEU has attempted to balance the risk of Member States not being able to tax the increase in value with the companies' free movement rights by allowing repayment over several years.[149] Alongside tax avoidance risks, exit taxation can incur administrative and compliance costs.

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[138] See Chapter Three section 3.4.1.
[139] Commission, 'Proposal for a Council Directive on a Common Corporate Tax Base (CCTB)' COM (2016) 685 final 14.
[140] ibid 10.
[141] ibid.
[142] 'Commission's proposals for a common consolidated corporate tax base' (2017) 38(2) Comp Law 57, 57.
[143] See Chapter One section 1.2.3.
[144] CCTB (2016) (n 139) 11, 15-16.
[145] ibid 15-16.
[146] ibid 11.
[147] Martins, 'The Portuguese corporate tax reform' (n 44) 286.
[148] Erik Röder, 'Co-ordination of corporate exit taxation in the internal market and beyond' [2014] BTR 574, 595.
[149] See Chapter Two section 2.3.1.

Finally, the complexity of corporate tax, which leads to increased compliance and administrative costs, has become 'unprecedented'.[150] One uniform method for assigning taxable profits amongst Member States would therefore reduce compliance costs administrative costs and the burden caused by the lack of transparency.[151] The Commission estimates that once both proposals are implemented, compliance time should reduce by 10% and compliance costs by 2.5%.[152] However, the Commission has acknowledged that administrative costs may increase with two parallel systems.[153] The non-compulsory nature (for most MNEs) may mean that costs do not substantially decrease.[154]

4.4.2 The Contentious and Disparate Effects of the 2016 Proposals

Both proposals extend cross border relief. The CCTB directive includes a temporary loss and recapture tool.[155] Future profits will be added to the tax base to the extent to which they were originally deducted.[156] The CCCTB directive consolidates the tax base automatically, providing cross border relief.[157] Member States will receive tax from loss-making companies if the group companies are profitable.[158] However, the proposal's overall effect on tax revenues differs among Member States, with a study on the 2011 proposal finding that those with 'a high corporate tax rate and a large multinational sector' would suffer greater falls.[159] This renders the exhaustive possibilities test, which was criticised for its complexities, redundant.[160] The simplification of loss relief offers greater benefits than the rules derived from negative harmonisation.[161]

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[150] John Snape, 'Corporation tax reform - politics and public law' [2007] BTR 374, 383.
[151] Emma Barraclough, 'EU pushes forward with consolidated tax base plans' (2002) 13(6) International Tax Review 4.
[152] CCTB (2016) (n 139) final 7.
[153] ibid 8.
[154] Gordon (n 37) 807.
[155] CCTB (2016) (n 139) 3, 42-43, 10-11.
[156] Commission, 'Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB)' (Proposal) COM(2016) 683 final 42.
[157] CCTB (2016) (n 139) 2.
[158] Matthias Petutschnig, 'Common Consolidated Corporate Tax Base and Limitation on Benefits Clauses' [2018] BTR 68, 70.
[159] Bettendorf and others, 'Corporate tax harmonization' (n 76) 558, 559.
[160] See Chapter Two section 2.3.2.
[161] CCTB (2016) (n 139) 5.

Furthermore, the proposals remove the need for intra-EU group transactions.[162] They apportion funds using an objective formula.[163] This reduces compliance costs as advance agreements can be expensive.[164] Europe will become more attractive to investors.[165] Tensions exist between wide interpretations of 'related parties', which punishes firms with no genuine economic links and implementing narrow interpretations, which allow intra-group companies to shift profits easily.[166] Over 60 per cent of cross border trade is intra-firm, and any reforms which attempt to regulate transfer pricing may struggle with establishing 'a market reference price' and for some goods 'whose value is rooted in unique brands and intellectual property' establishing the economic price is even harder.[167] However, Member States use of profit shifting is currently unequal, meaning its abolition affects Member States differently.[168] The Commission has noted that transfer pricing can only be stopped through a uniform and singular approach.[169]

Importantly, tax competitive pressures will transfer to the tax rate.[170] Member States would continue to retain tax rate sovereignty,[171] meaning they would compete through their tax rate.[172] Although the tax rate is the 'visible part of the iceberg' with the real issue being 'the tax base',[173] changes will be more influential when tax bases are harmonised because their effect on the effective corporate tax rate will increase.[174] Increased 'divergence' is therefore expected.[175] A combined tax base encourages competition of tax rates which will necessitate a uniform rate.[176] The European Parliament has acknowledged that tax rates may require harmonisation, and corporation tax may need 'to become a non-competitive'.[177] Removing

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[162] Edoardo Traversa, 'Interest Deductibility and the BEPS Action Plan: nihil novi sub sole?' [2013] BTR 607, 614; Jamie Morgan, 'Taxing the powerful, the rise of populism and the crisis in Europe: the case for the EU Common Consolidated Corporate Tax Base' (2017) 54(5) Int Polit 533, 544.
[163] CCTB (2016) (n 139) 2.
[164] 'Common consolidated corporate tax base proposed' [2011] EU Focus 1, 2.
[165] Martins, 'The Portuguese corporate tax reform' (n 44) 286.
[166] ibid.
[167] Morgan (n 162) 537.
[168] Bettendorf and others, 'Corporate tax harmonization' (n 76) 559.
[169] CCTB (2016) (n 139) 5.
[170] Bond and others (n 96); Adina Trandafir, 'Tax Harmonization Measures at EU Level in the Corporate Tax Field' (2013) 5(2) Contemp Read Law Soc Justice 647, 653ff.
[171] Trandafir, 'Tax Harmonization Measures' (n 170) 650; 'Commission proposes major corporate tax reform for EU' [2016] EU Focus 40, 40; Commission's proposals (n 142) 57.
[172] 'Common consolidated corporate tax base proposed' (n 164) 3.
[173] Tromans (n 43) 56.
[174] Brøchner (n 60) 580; Bettendorf and others, 'Corporate tax harmonization' (n 76) 567.
[175] Bettendorf and others, 'Corporate tax harmonization' (n 76) 569.
[176] Frank Zipfel, 'One Europe, one tax? Plans for a common consolidated corporate tax base' (2008) 51 Euro News 1, 5.
[177] Morgan (n 162) 548.

tax as a method for attracting FDI altogether will disproportionately harm smaller Member States.[178] Therefore, tax base harmonisation does not eradicate investment distortions and could worsen them.[179]

The CCCTB considers the many separate entities within a group company to be 'a single entity for tax purposes'.[180] Formulary apportionment creates disparate effects. The 2011 formula 'introduce[d] as much distortions as the CCCTB aim[ed] to remove'.[181] The 2016 formula relies on three factors: labour, assets, and sales according to destination with the ECON Committee proposing data as the fourth weighted factor.[182] The formula must satisfy all Member States to achieve consensus.[183] The design remains a major hurdle to this.[184] The factors attempt to strike a balance between the Member State of origin, through labour and assets, and the Member State of destination, through sales.[185] There is no consensus on what a fair allocation is.[186] The USA could not 'agree on a single formula', which suggests that the more diverse EU is unlikely to achieve a consensus.[187]

Member States set their tax rates.[188] The factors represent the source of profits and are based on widely available data.[189] The original formula was criticised for relying on 'the number of employees' as this limited the influence of productivity.[190] The 2016 proposal does not

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[178] See Chapter One section 1.2.2.1.
[179] Brøchner (n 60) 580.
[180] Morgan (n 162) 543.
[181] Bettendorf and others, 'Corporate tax harmonization' (n 76) 578.
[182] Committee on Economic and Monetary Affairs, 'Common Consolidated Corporate Tax Base' (Amendments A8-0051/2018) Amendment 10 <https://www.europarl.europa.eu/doceo/document/A-8-2018-0051-AM-001-065_EN.pdf> accessed 23 August 2021. Also see European Parliament's response: European Parliament, 'European Parliament legislative resolution of 15 March 2018 on the proposal for a Council directive on a Common Consolidated Corporate Tax Base (CCCTB)' (European Parliament 2014-2019, 15 March 2018) amendment 10 <https://www.europarl.europa.eu/doceo/document/TA-8-2018-0087_EN.pdf> accessed 23 August 2021.
[183] Helen Rogers and Lynne Oats, 'Emerging Perspectives on the Evolving Arm's Length Principle and Formulary Apportionment' [2019] BTR 150, 156.
[184] Herzig and Kuhr (n 39) 11.
[185] Martins, 'The Portuguese corporate tax reform' (n 44) 286.
[186] Malcolm Gammie, 'Taxing corporate profits in a global economy' [2013] BTR 42, 56; Zipfel (n 176) 3, 5.
[187] Yariv Brauner 'Formulary Taxation and Transfer Pricing: The Good, the Bag and the Misguided' in Ana Paula Dourado (ed) *Movement of Persons and Tax Mobility in the EU: Changing Winds* (IBFD 2013).
[188] Gordon (n 37) 805.
[189] 'Common consolidated corporate tax base proposed' (n 164).
[190] Andreas Oestreicher and Reinald Koch, 'The Revenue Consequences of Using a Common Consolidated Corporate Tax Base to Determine Taxable Income in the EU Member States' (2011) 67(1) FinanzArchiv 64, 84-85.

consider productivity and instead attempts to consider the differences in average wages across Member States.[191] The 2011 formula favoured 'labour-intensive countries' over 'capital-intensive countries'.[192]

The formula favours Member States maintaining 'old industry' by ignoring the location of intangible assets.[193] It also ignores questions over online payments and the differing levels of risk associated with activities in different Member States.[194] Value creation is ignored despite the Commission's support of the principle.[195] Under one analysis of a potential formula, 'smaller countries' which attracted FDI through tax competition saw their tax base shrink.[196] A subsequent study showed that low tax jurisdictions would see a reduction in revenues, and only five Member States would win under the original proposal,[197] despite most tax bases expanding.[198] Choosing the right formula is difficult.[199] The formula will suffer from 'unforeseen problems' which the EU cannot 'anticipate in advance'.[200] As such, formulary apportionment and its disparate effects act as a major hurdle to implementation.

Tax avoidance and competition will continue by adjusting to new tax planning practices like factor shifting, which is the manipulation of the chosen factors.[201] MNEs may invest in labour in low-tax Member States,[202] including unproductive labour.[203] However, the proposals include provisions that will prevent artificial manipulations by MNEs.[204] Nevertheless, Member States may manipulate the formula by manipulating the definition of

[191] CCCTB (2016) (n 156) 10.
[192] Bettendorf and others, 'Corporate tax harmonization' (n 76) 558-559.
[193] Gordon (n 37) 808.
[194] ibid 806; Zipfel (n 176) 4.
[195] Michael P Devereux and John Vella, 'Taxing the Digitalised Economy: Targeted or System-Wide Reform?' [2018] BTR 387, 395.
[196] Clemens Fuest, Thomas Hemmegarn and Fred Ramb, 'How would the introduction of an EU-wide formula apportionment affect the distribution and size of the corporate tax base? An analysis based on German multinationals' (2007) 14(5) Int Tax Public Finance 627.
[197] Oestreicher and Koch (n 190) 68, 78.
[198] ibid 67.
[199] Zipfel (n 176) 4.
[200] Walter Hellerstein, 'Formulary Apportionment in the EU and the US: A Comparative Perspective on the Sharing Mechanism of the Proposed CCCTB' in Ana Paula Dourado (ed) *Movement of Persons and Tax Mobility in the EU: Changing Winds* (IBFD 2013) 459.
[201] Rogers and Oats (n 183).
[202] Eva Eberhartinger and Matthias Petutschnig, 'CCCTB: the employment factor game' (2017) 43(2) Eur J Law Econ 333, 354.
[203] Martins, 'The Portuguese corporate tax reform' (n 44).
[204] Morgan (n 162) 544-545.

an ‘employee’.[205] The proposals may be successful at tackling the problems as they currently manifest. However, a full solution is not achieved until the underlying causes are addressed.

4.4.3 Compliance with the Legal Framework

Proportionality has three components, suitability, necessity, and proportionality in the strict sense, which means that the disadvantage of a measure must be proportional to the measures’ objective.[206] There are two hurdles to establishing proportionality. Firstly, the effect the proposals have on Member States’ sovereignty. The Commission insists that the measures are proportional because they only harmonise the corporate tax base, allowing Member States to determine their own tax revenues via tax rates.[207] Furthermore, the Commission believes coordination efforts would be insufficient due to being too slow and narrow in nature.[208] The measure is only mandatory for the largest companies, which must be included to tackle tax avoidance.[209] However, the Commission believes the first directive would make the system of corporate tax in the EU fairer and more efficient compared with the current system,[210] undermining the necessity of the second directive. Secondly, the impact of the measures, particularly the disparate effects, act as a hurdle. Member States which rely on their tax policy to secure FDI are disproportionately affected.[211] Furthermore, the Commission cannot prove the impact the measures will have. Currently, the uncoordinated nature of corporate taxation in the EU facilitates tax avoidance by MNEs.[212] Through harmonising the tax base, the proposals make it more difficult for MNEs to implement aggressive tax planning strategies.[213] Two avenues for tax avoidance, transfer pricing and preferential tax regimes, are closed down by the proposals.[214] However, the lack of any real precedent means that the extent to which the measure will produce benefits rather than disadvantages is unclear.[215] This means that the measure cannot easily meet the strict proportionality element of the test.

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[205] Eberhartinger and Petutschnig (n 202).
[206] Gordon (n 37) 809, 810.
[207] CCTB (2016) (n 139) final 5-6.
[208] ibid 5.
[209] ibid 9.
[210] ibid 3-4.
[211] Oestreicher and Koch (n 190) 68, 78.
[212] ‘Commission presents action plan for "fair and efficient" corporate taxation in EU’ [2015] EU Focus 33.
[213] ‘Commission proposes major corporate tax reform for EU’ (n 171).
[214] ibid.
[215] Röder (n 148).

With regards to subsidiarity, the proposals are tackling problems that affect the EU's internal market and need a uniform solution. The CJEU often assesses subsidiarity according to whether the objectives can be better achieved at EU level for measures involving the internal market, such as in *Vodafone*.[216] The cross-border nature of the proposals facilitates compliance with the principle of subsidiarity.[217] The Commission believes Member States acting individually would not produce a coordinated result and could exacerbate the problems.[218]

Finally, the principle of conferral requires that Article 115, the correct legal base is used. The Commission understands that the implementation of the proposals is unlikely to take place in the near future.[219] It is unlikely to overcome the political hurdles needed for implementation soon.[220] The 2016 proposals will not gain the necessary unanimous approval of all Member States.[221] Enhanced cooperation is a potential legal basis for the 2016 proposals. Many measures, including the 2016 proposals, do not affect all Member States equally.[222] This means the unanimity requirement would be difficult to overcome. However, those Member States who stand to benefit under a combined tax base may not benefit if some Member States do not implement the proposals.[223]

The current use of enhanced cooperation is not analogous to the CCCTB proposal. For example, the applicable divorce law regulation simplified the process for two EU citizens from different Member States to divorce.[224] Enhanced cooperation can work for divorce laws because the number of Member States participating does not affect the quality, or effectiveness, of the regulation for those Member States who are participating. Another example is the Unitary Patent which provides the option of gaining patent protection in the participating Member States through a singular request as opposed to requiring a separate

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[216] Case C-58/08 *The Queen, on the application of: Vodafone Ltd and Others v Secretary of State for Business, Enterprise and Regulatory Reform* [2010] ECR I-5026, paras 20, 72.
[217] Ioanna Mitroyanni, **'**The common consolidated corporate tax base: accomplished steps and the way ahead' [2011] BTR 246, 247.
[218] CCCTB (2016) (n 156) 4-5.
[219] Sir Philip Lowe, 'The Commission's powers to enforce the law: and to propose changes to it' (2017) 42(6) EL Rev 909, 912-913.
[220] Antony Ting, 'iTax - Apple's International Tax Structure and the Double Non-Taxation Issue' [2014] BTR 40.
[221] Rudolf Streinz, 'Multilateral Instrument and EU Competence' [2015] BTR 429, 443.
[222] Leon Bettendorf and others, 'Corporate Tax Consolidation and Enhanced Cooperation in the European Union' (2010) 31(4) Fiscal Studies 453, 454, 472, 477.
[223] ibid 477.
[224] Council Regulation (EU) No 1259/2010 of 20 December 2010 implementing enhanced cooperation in the area of the law applicable to divorce and legal separation [2010] OJ L343/10.

request for each Member State.[225] The Unitary Patent shares similarities with the CCCTB proposal as there were many previous failed attempts at unifying patents before enhanced cooperation, and it simplifies processes for businesses.[226] However, the Unitary Patent demonstrates that enhanced cooperation can still face challenges from non-participating Member States.[227] Furthermore, while the Unitary Patent does provide an example of successful enhanced cooperation, its success does not necessarily mean that enhanced cooperation would work for the CCCTB proposal. Firstly, the effect of the Unitary Patent on participating Member States is significantly less than the effect of the CCCTB proposal with the 'classical' system of businesses applying for patent protection in each Member State being retained, thus making engagement with the new system entirely optional.[228] This makes it more analogous to the 2011 CCTB proposal than the 2016 CCCTB proposal.[229] Secondly, there are still additional requirements which some Member States have placed on businesses who wish to use this new system surrounding translation requirements when claims are made.[230] This new system therefore does not impose as many changes as the 2016 CCCTB proposal. Furthermore, as with the comparison to the divorce regulations, the existence of non-participating Member States only reduces its geographical scope.

However, the non-participating Member States will likely impair the benefit of increased tax integration.[231] With the benefits of a combined base reducing, those Member States who would initially support the proposals may not wish to pursue their partial implementation.

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[225] Council Regulation (EU) No 1257/2012 of 17 December 2012 implementing enhanced cooperation in the area of the creation of unitary patent protection [2012] OJ L 361/1; Council Regulation (EU) No 1260/2012 of 17 December 2012 implementing enhanced cooperation in the area of the creation of unitary patent protection with regard to the applicable translation arrangements [2012] OJ L 361/89; European Commission, 'Unitary patent' (Europa) <https://ec.europa.eu/growth/industry/strategy/intellectual-property/patent-protection-eu/unitary-patent_en#:~:text=The%20unitary%20patent%20is%20a,a%20single%2C%20specialised%20patent%20jurisdiction.> accessed 16 March 2022.

[226] ibid; Ministry of Justice, Government Offices of Sweden, 'An Enhanced European Patent System' (The Select Committee and The Preparatory Committee 2014) < https://www.unified-patent-court.org/sites/default/files/enhanced-european-patent-system.pdf> accessed 16 March 2022, page 2; Christopher Wadlow, 'An Historical Perspective II: The Unified Patent Court' in Justine Pila and Christopher Wadlow (eds) *The Unitary EU Patent System* (Hart Publishing 2017).

[227] Cases C-274/11 and C-295/11 *Kingdom of Spain and Italian Republic v Council of the European Union* [2013] ECR 240 1.

[228] Ministry of Justice (n 46) page 3.

[229] CCCTB (2011) (n 122), 6; Mason and Parada (n 136).

[230] European Patent Office, 'IV Translation requirements after grant pursuant to Article 65 EPC' (EPO) < https://www.epo.org/law-practice/legal-texts/html/natlaw/en/iv/index.htm> accessed 16 March 2022.

[231] Gammie, 'Taxing corporate profits' (n 186) 54.

Enhanced cooperation could lead to successes which would encourage other Member States to opt-in. However, partial harmonisation would most likely dilute the potential successes that a CCCTB implemented by every Member State could produce. It would also be unlikely to sway the opinions of a Member State like Ireland who relies on FDI, which it attracts using tax policies. Although, a key issue regarding the CCCTB is whether it will be able to adapt to the dynamic nature of the business world.[232] Enhanced cooperation may provide the flexibility needed for the measures to adapt.

Therefore, examples of the successful use of enhanced cooperation shows that it can be used to implement the CCCTB proposal but the differences between the Unitary Patent and the CCCTB proposal means it is unlikely to be able to achieve the same results as implementation requiring unanimous support would.[233]

Furthermore, despite implementation through enhanced cooperation being significantly easier, enhanced cooperation does not guarantee the successful implementation of measures. In 2013, the EU proposed the Financial Transaction Tax using enhanced cooperation however Slovenia's official withdrawal in 2016 left the EU without sufficient support.[234] The initiative would harmonise taxes on the financial sector which would reduce both tax avoidance and double taxation.[235] While negotiations for the Financial Transaction Tax remain ongoing, the hurdles it has faced suggest that the 2016 proposals, which are significantly more substantial, will struggle to gain sufficient support.

Overall, enhanced cooperation is an alternative avenue for successful implementation of the CCCTB proposal as it does not require unanimous support which, as this thesis has explained, is highly unlikely.[236] However, comparisons with previously successful enhanced cooperation demonstrates that should the CCCTB proposal be implemented this way, they are unlikely to achieve the same results as those implemented with unanimous approval as the existence of non-participating Member States will have a detrimental effect on the success of the CCCTB proposal.[237] As this section has shown, those Member States who

[232] Zipfel (n 176).
[233] Gammie, 'Taxing corporate profits' (n 186) 54.
[234] European Parliament, 'Legislative Train Schedule: Financial Transaction Tax' <https://www.europarl.europa.eu/legislative-train/theme-deeper-and-fairer-internal-market-with-a-strengthened-industrial-base-taxation/file-financial-transaction-tax> accessed 22 September 2021.
[235] European Commission, 'Taxation of the financial sector' <https://ec.europa.eu/taxation_customs/financial-transaction-tax_en> accessed 22 September 2021.
[236] Tsebelis (n 41); Jupille (n 47); Berglöf (n 48).
[237] Gammie, 'Taxing corporate profits' (n 186) 54; ibid 477.

would benefit under the CCCTB proposal implemented with unanimous support would see their benefits reduce and this could lead to them abandoning the proposal altogether which would mean that the minimum number of participating Member States may not be reached.

4.4.4 The 2016 Proposals as an Answer to the Disjointed Corporate Tax Systems

The proposals must be assessed on the basis of their effect if implemented and their ability to be implemented. With regards to the former, the effectiveness of the proposals must be assessed against the problems identified in Chapter One. Firstly, the 2016 proposals largely tackle the costs which arise when each Member State has a different tax system as the introduction of a single set of uniform rules means that compliance costs should fall, tax administrators will have to operate two parallel systems, which could increase their costs.[238] Secondly, tax competition will diminish since formulary apportionment allocates profits from the consolidated tax base according to genuine activity.[239] However, the proposals primarily tackle tax competition as it currently manifests and not its underlying causes, which means tax competitive behaviours are likely to continue and adapt in response to the 2016 proposals, like manipulating the definition of an employee.[240] Furthermore, Member States will retain sovereignty over their tax rates.[241] Finally, the 2016 proposals tackle tax avoidance through several measures, including equalising the treatment of debt and equity, CFC rules and reducing the need for intra-EU transfer pricing. While only the largest MNEs will be required to follow the proposals,[242] these MNEs are most capable of tax avoidance. With regards to the latter, the proposals are likely to be considered compliant with the principle of proportionality and subsidiarity.[243]

The main hurdle to effective implementation is Article 115's unanimity requirement as the proposals remain unlikely to gain the necessary unanimous support.[244] The barriers to unanimity have only increased since European enlargement, which increased 'heterogeneity

[238] Gordon (n 37).
[239] ibid.
[240] Eberhartinger and Petutschnig (n 202).
[241] Trandafir, 'Tax Harmonization Measures' (n 170) 650.
[242] CCTB (2016) (n 139) 9.
[243] See objections, European Scrutiny Committee, *Taxation: a common consolidated corporate tax base* (HC 2016-2017, 71-xxi) 1, 10-12. Also see, Oskar Cimmerholm, 'The re-launched CCCTB proposal - an analysis of its compliance with Protocol (No 2) on the application of the principles of subsidiarity and proportionality' (Graduate Thesis, Lund University 2016) <http://lup.lub.lu.se/luur/download?func=downloadFile&recordOId=8897830&fileOId=8900263> accessed 23 August 2021.
[244] Lowe (n 219) 912-913.

across fiscal systems' in the EU.[245] One barrier to unanimous support is that there is no precedent.[246] Member States are wary of implementing major changes when there is no precedent that proves the theories and methodologies on which the proposals rely.[247] The 'revenue consequences' of the 2016 proposals and the previous CCCTB also remain unclear.[248] As such, the proposals can only be implemented using enhanced cooperation.

4.5 Alternative Positive Integration Solutions

Alternatively, solutions exist. 'Targeted' directives may be more realistic to implement.[249] Such directives, like the ATAD, have past success.[250] Likewise, pursuing soft laws instead of hard laws may lead to progress. Hard laws are legally binding,[251] Whereas soft laws are not legally binding.[252] Pursuing soft-law measures is seen as a compromise since it protects Member States' sovereignty.[253] Soft law can enhance progress and lead to Member States considering changes that they would block if they were presented as part of a directive. Soft laws can 'impact… domestic tax regimes'.[254] They can therefore 'have practical effect' including through setting 'a certain standard for (desired) conduct'.[255] For example, the Code of Conduct for business taxation is soft law.[256] Soft law has some legal effects, including 'judicial recognitions'.[257] However, such legal effects have been labelled 'problematic'.[258]

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[245] Bettendorf and others, 'Corporate tax harmonization' (n 76) 581.
[246] Fabrizio Bendotti, 'Integration Approaches to Group Taxation in the European Internal Market' [2009] BTR 705, 705.
[247] ibid 707.
[248] Oestreicher and Koch (n 190) 65.
[249] Panayi, 'Reverse subsidiarity and EU tax law' (n 59) 301.
[250] Rules Against Tax Avoidance Practices (n 128).
[251] TFEU [2016], art 288.
[252] ibid.
[253] Emilia Korkea-Aho, 'EU Soft Law in Domestic Legal Systems: Flexibility and Diversity Guaranteed?' (2009) 16(3) Maastricht Journal of European and Comparative Law 271, 272-273.
[254] Eric CCM Kemmeren, 'Sources of EU Law for European Tax Integration: Well-Known and Alternative Legal Instruments' in Dennis Weber (Ed) *Traditional and Alternative Routes to European Tax Integration* (IBFD 2010) 41.
[255] Dennis Weber, 'The General Report' in Dennis Weber (Ed) *Traditional and Alternative Routes to European Tax Integration* (IBFD 2010) 5.
[256] Kemmeren (n 254).
[257] Korkea-Aho (n 253).
[258] Oana Stefan, 'European Union Soft Law: New Developments concerning the Divide between Legally Binding Force and Legal Effects' (2012) 75(5) Mod L Rev 879, 880, 893.

Soft law is used either to 'supplement' hard law or as a 'pre-cursor to hard law'.[259] Furthermore, the Member States who raise the most opposition to hard-law developments, such as the 2016 proposals, are unlikely to be influenced by soft-law due to their heavy reliance on using tax to attract FDI. Finally, tax rate harmonisation, which would be administratively simpler than tax base harmonisation,[260] could be pursued. The 'competitive pressure' on tax rates would be abolished if the rates were the same.[261] A more radical approach would be for every Member State to abolish their corporate tax.[262] Such a move would only be logical if Member States believed that a 0% rate was inevitable and any competitive advantage gained would not last long as any significant shift in FDI would be met by other countries responding accordingly.[263] While corporate tax rates are facing a 'downward trend',[264] the rates are mostly a long way from 0%, and it would be disadvantageous for Member States to accelerate this trend.[265]

4.6 The Role of Positive Harmonisation in Overcoming the Differences Between EU Corporate Tax Systems.

The EU has used other methods to pursue the integration of sensitive areas such as tax in recognition of the political hurdles.[266] Positive harmonisation may initially appear to be a reliable solution for overcoming the problems of different corporate tax systems in the EU since any positive harmonisation measure would be specifically designed for corporate tax situations and so should avoid the flaws associated with both forms of negative harmonisation. However, the unanimity requirement makes this unlikely. Therefore, the resulting harmonisation is likely to consist of many haphazard and incoherent measures rather than one or two broad and coherent measures. Measures such as the 2016 proposals which could tackle the Chapter One problems are unlikely to gain unanimous support. The implementation of the ATAD is not analogous to other corporate tax harmonisation proposals such as the 2016 proposals. Firstly, it was a response to the OECD's BEPs action

[259] Gribnau (n 110) 77.
[260] Bond and others (n 96) 67.
[261] ibid.
[262] ibid 74.
[263] ibid.
[264] ibid.
[265] See Chapter One section 1.2.2.2.
[266] Rita de la Feria and Clemens Fuest, 'The economic effects of EU tax jurisprudence' (2016) 41(1) EL Rev 44, 52.

plan, which many Member States would have implemented regardless. Secondly, it is highly specific and focused on tackling tax avoidance. Thirdly, similar measures were adopted by the majority of countries worldwide. Therefore, Member States did not need to worry about how the measure could affect the competitiveness of the internal market. A key flaw of any positive harmonisation measure would be its limited application to non-EU countries.[267] Any measure which tackles tax avoidance will raise the cost of doing business in the EU. Other than the ATAD, the EU has struggled to implement corporate tax measures.

4.7 Conclusion

There are other flaws with using positive harmonisation. Firstly, an effective measure would need to tackle both competition of the corporate tax base and the corporate tax rate. As Chapter Four's analysis of the 2016 proposals has demonstrated, tackling one transfers competitive pressures onto the other. This is because the causes of tax avoidance and tax competition: MNEs' desire to lower their costs by reducing their taxes and Member States' desire to attract FDI are still present. Without tackling the underlying causes, the demand for tax competition and avoidance still exists and may emerge in other forms. Furthermore, a flaw of negative harmonisation is that the CJEU is not a specialist tax court, and their judgments can be ill-suited, resulting in messy and chaotic case law. However, even the best positive harmonisation measure will still be subject to the CJEU's judgments when challenges surrounding its application arise. As such, in the future, negative harmonisation will provide progress in the field of direct corporate taxation, not positive harmonisation.

[267] Bond and others (n 96) 66, 68.

Conclusion

This thesis sought to identify the problems which derive from each Member State having their own corporate tax system, to assess what harmonisation has already taken place and its effectiveness, and to explore positive harmonisation and whether it would be more effective than negative harmonisation. Through these aims, this thesis has extensively assessed corporate tax in the EU.

Chapter One addressed the first question by identifying three primary problems which stem from Member States having different tax systems. Chapter One had two primary functions. Firstly, an analysis and assessment of corporate tax harmonisation presuppose that the corporate tax system ought to be harmonised, or at least significantly integrated because not doing so creates adverse effects on the EU or on the participants of its internal market. Secondly, by identifying why the differences between Member States' corporate tax systems creates problems and by identifying what those problems are, it is easier to assess both positive and negative harmonisation measures as many methods of harmonisation tackle specific problems. This chapter identified three categories of problems. Firstly, the costs of the differences in corporate tax systems. Secondly, competition between Member States who use their tax regimes to make their state a more attractive place for inward FDI than other Member States. Thirdly, tax avoidance by MNEs who exploit the loopholes between the different corporate tax systems to lower their costs through minimising their tax burden. All three problems are significant, although there is considerable overlap between them. For example, part of the costs derived from the differences between the tax systems is the inefficiencies in the complete collection of corporate tax. This means there is a large gap between potential tax revenue and actual tax revenue. This is linked to the tax avoidance behaviours of MNEs and also to the tax competition Member States engage with. Furthermore, it is possible for Member States to enable MNEs to avoid tax by competing via their tax policies for FDI. The different problems demonstrate that multiple internal market participants are involved in exacerbating the problems. This is relevant when considering the requirements for passing positive harmonisation measures, which would require the approval of every Member State. Since some Member States actively exacerbate the problems to compete for FDI, unanimity is unlikely to be achieved. Any measure must consider both the behaviours of MNEs and of Member States.

This thesis then considered negative harmonisation. Analysing negative harmonisation has served two primary purposes. Firstly, it has acted as a comparator for positive harmonisation

since introducing positive harmonisation only makes sense if it would provide a superior and more effective response than the negative harmonisation, which has already taken place. It has, therefore, been necessary to understand what harmonisation has been achieved and the extent to which it has addressed or minimised the problems identified in Chapter One. Secondly, analysing and evaluating negative harmonisation means that any pitfalls or flaws were identified. This has enhanced this thesis's analysis of positive harmonisation.

The first half of negative harmonisation explored in this thesis was the four freedoms case law. This was explored in Chapter Two and focused on establishment and capital. The establishment case law can be categorised into the type of tax which has allowed this thesis to identify reoccurring themes and see how the CJEU has balanced the competing needs of the MNEs and the Member States. Throughout exit taxes, cross border relief and CFCs and profit shifting cases, the CJEU has attempted to strike a balance between these competing economic interests by differentiating genuine economic activity from exploitation and abuse. When assessing exit taxes, the CJEU does not allow immediate taxation as this could prevent genuine relocations. However, to prevent the freedom of establishment from being used by MNEs to avoid tax yet to be paid on unrealised gains, a number of provisions such as guarantees or yearly instalments have been accepted for exit taxes levied on companies. Loss relief must be extended to cross border situations only if there are no loss relief provisions in the Member State in which it occurred. This prevents MNEs from relying on the treaties to use their losses to lower their tax burden in high-tax Member States. The CJEU has also relied on the notion of wholly artificial arrangements to differentiate between genuine economic activity and artificial activity, which serves only to exploit the treaties. The free movement of capital is less established and predominantly focuses on discrimination in the treatment of dividends. Through this, it has been able to minimise the differences in treatment for some situations.

Chapter Two demonstrated that the freedoms do affect corporate taxation in the EU. However, by their very nature, they are designed to protect the rights of MNEs. Despite this, the chapter demonstrated that the CJEU recognises the importance of preventing taxpayers from abusing the treaties and that it recognises that the Chapter One problems will worsen without careful consideration. However, the safeguards introduced by the CJEU to prevent abuse of the treaties are often too weak to comprehensively tackle the Chapter One problems since the CJEU can only apply the treaties and cannot introduce new laws. For instance, wholly artificial arrangements were characterised by the CJEU, in the context of CFCs, as consisting of no more than a letterbox. Furthermore, numerous problems such as the freedoms and the CJEU not being tax specific have led to accusations that the resulting harmonisation is not clear or consistent and is instead chaotic and messy.

The second half of negative harmonisation examined in this thesis is Article 107, which is the EU's State aid controls. Chapter Three firstly provided an overview of the criteria and the ways in which Article 107's use has evolved in the EU before assessing recent State aid tax rulings. The recent rulings can be divided into three categories. Firstly, profit allocation rulings emphasise the importance of reflecting economic reality in tax rulings that endorse transfer pricing strategies of particular MNEs. The investigations discussed are the *Apple* Decision, the *Amazon Decision*, the *Starbucks Decision* and the *Fiat Decision*. These cases demonstrated several issues, including the new European Arm's Length Principle, which has caused controversy since it deviates from internationally used Arm's Length Principles. Secondly, the *Apple Decision* demonstrated how retroactivity could be problematic as some of the tax did not need to be repaid as it was too long ago. Thirdly, the profit allocation decisions demonstrate that even where the State aid criteria are fulfilled, the Decisions can be highly controversial. The second category is those that tackle national tax regimes rather than specific tax rulings, which the recent investigations mostly centre around. The lack of cases that focus on entire tax regimes means that the harmonisation that occurs too often relates to a highly specific ruling and are therefore rarely widely applicable, limiting the impact of any given ruling. The analysis in this section did, however, suggest that State aid controls are not easily applied to national tax regimes.

Finally, tax rulings concerning double non-taxation demonstrated the rigidity of the criteria and how it ultimately acts detrimentally to its use as a tool for regulating tax rulings. *McDonald's* and *Engie* both benefitted from double non-taxation, which inevitably provided them with a competitive advantage through a substantial decrease in costs via a reduction in tax levied against them. However, no State aid was found in the former since the double non-taxation arose from the differences between the Luxembourgish and American tax systems. Therefore, State aid controls are not a reliable tool for regulating tax rulings and tackling the Chapter One problems. Chapter Three, therefore, illustrated that State aid controls could be used to affect corporate tax in the EU. However, this is contingent upon all of Article 107's criteria being satisfied. The CJEU and the Commission only have the power to act where these conditions are met. This chapter also demonstrated that the Commission has been largely unsuccessful in the General Court. This is predominantly because they have attempted to apply very rigid criteria, which was not designed to tackle tax rulings. However, the Commission has appealed numerous General Court judgments. The ECJ has the power to overrule the General Court, and the outcome of these appeals could change the perceived merits of using Article 107 to regulate tax rulings.

Together, Chapter Two and Chapter Three form this thesis's negative harmonisation analysis. The chapters showed that the two forms of negative harmonisation do not

complement one another. State aid controls deter precise rules, whereas the four freedoms deter general rules. For example, after the UK's CFC regime was found to violate the freedom of establishment in *Cadbury Schweppes*, the UK amended their rules only to be found to violate Article 107 partially. The tension between the two forms of negative harmonisation does little to address criticisms which are levied at both, including that their resulting harmonisation is chaotic and messy. While some overarching rules can be drawn from different segments of negative harmonisation case law, the rules are not examples of actual harmonisation as the CJEU is not bound by them and may deviate from them in future judgments. Therefore, neither has been able to produce clear and consistent rules, and this is why the last substantive chapter of this thesis analysed positive harmonisation.

Chapter Four addressed the full spectrum of harmonisation and integration measures. Its purpose was to establish whether positive harmonisation provides a better solution to the problems identified in Chapter One than negative harmonisation. This chapter began by providing an overview of the principles which govern positive harmonisation. This was followed by a brief overview of past harmonisation attempts in the EU, which is essential to establish what past hurdles prevented progress and understand what positive harmonisation measures have been successfully implemented. For instance, the main focus of this chapter is on the 2016 proposed directives, which is the Commission's response to the difficulties it faced in gaining enough political will to pass the 2011 proposal in one go. The 2016 proposals are the current Commission proposals and are analysed in Chapter Four concerning how effective they are likely to tackle the problems in Chapter One. However, as Chapter Four illustrated, the proposals are primarily effective at tackling the problems as they currently manifest and do little to resolve the underlying causes, which will most likely lead to behaviour adaption as opposed to actually tackling the Chapter One problems. These underlying causes refer to the MNEs' desire to reduce costs by avoiding tax and the desire of Member States to increase inward FDI through attracting investment using favourable tax treatment. Chapter Four also demonstrated the difficulties of implementing the proposals. The legal hurdles which refer to compliance with EU principles are easily met. However, the unanimity requirement poses a problem since gaining political support from every Member State is near impossible when some Member States benefit from the current system. The more effective a measure is likely to tackle the Chapter One problems, the less likely it is to gain unanimous support. Chapter Four also demonstrated that partial implementation via enhanced cooperation would fail to realise the benefits expected of full implementation. Lastly, alternative solutions were briefly discussed to demonstrate how the hurdles to full implementation of the proposals would also make it challenging to implement any other highly effective positive harmonisation measure.

Chapter Four demonstrated that positive harmonisation would, almost certainly, provide a more effective tool for tackling the problems identified in Chapter One as they currently manifest. Unfortunately, this chapter also demonstrated that highly effective positive harmonisation measures will almost certainly not gain the unanimous approval required. For a long term solution that would not lead to any behaviour adaptions, a measure would need to address the underlying causes, the desires of Member States who want to attract inward investment and MNEs who want to reduce their costs. An effective measure would not necessarily remove these causes but would pre-empt them by ensuring that the proposed measure had no alternative elements through which Member States could continue to compete.

Throughout all four substantive chapters, this thesis has demonstrated that although theoretically, positive harmonisation would provide a better response, all immediate future progress will be derived from the two forms of negative harmonisation, which, despite their flaws, are both currently available for use by taxpayers and the Commission alike. The effect of this is that problems will continue to arise. The deadlock between the many Member States who want or need corporate tax reform due to their experience of the current system's adverse effects and the Member States who oppose reform either because they benefit from the current situation or because they value their tax sovereignty over any negative effects they may experience will continue. The unanimity requirement means that the latter Member States can veto any proposals. The more effective a measure is likely to be, the less likely it is that a measure will be implemented. So, while most Member States may benefit, effective positive harmonisation measures remain unlikely. The former Member States are also limited by the free movement provisions, which make unilateral action difficult and, in many instances, a treaty violation. In the immediate future, the deadlock will continue, and the inaction of the EU will exacerbate the Chapter One problems. The uneven nature of the deadlock will also likely exacerbate tensions between the two sides.

As stated earlier, progress in the immediate future will be made through negative harmonisation. The effectiveness of such harmonisation could improve as the CJEU is capable of changing. As discussed, the ECJ may overrule the General Court's State aid jurisprudence. There is also the possibility of the CJEU's free movement interpretations evolving as they have done in other instances, such as mutual recognition discussed in Chapter Two. However, this development serves as an exception to the rule, and substantial evolution remains unlikely. There is also the possibility of pursuing less aggressive positive harmonisation measures. The Commission must establish which areas are likely to face the least resistance. Such weakened positive harmonisation measures would not resolve the

Chapter One problems and instead would serve to assist negative harmonisation in the immediate future.

Word Count: 45, 876 (excluding bibliography and front matter).

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