E U R O P E A N  U N I O N  C O R P O R A T E  T A X  L A W

SECOND EDITION

How does EU law affect Member State corporate tax systems and the cross-border activities of companies? This book traces the historical development of EU corporate tax law and provides an in-depth analysis of a number of issues affecting companies, groups of companies, and permanent establishments. Christiana HJI Panayi examines existing legislation, soft law, and the case law of the Court of Justice, as well as the Commission’s burgeoning external tax policy initiatives. The book not only explores the tax issues pertaining to direct investment, but also analyzes the taxation of passive investment income, corporate reorganisations, exit taxes, and the treatment of anti-abuse regimes. Through this analysis, the book highlights the convergences and divergences arising from the interplay between EU corporate tax law and international tax law, especially the OECD Model Tax Convention. This second edition also reviews developments in the context of the State aid prohibition and high-profile investigations on Member State tax rulings.

Christiana HJI Panayi is a Professor in Tax Law in the Centre for Commercial Law Studies at Queen Mary University of London. She has served as an expert member in the European Commission’s Joint Transfer Pricing Forum, the Platform for Tax Good Governance and the UK’s Institute for Fiscal Studies. She has previously held positions at NYU and Sorbonne University. She is a (non-practicing) solicitor of England & Wales and an advocate of the Cyprus Supreme Court.
Tax law is a growing area of interest. It is included as a subdivision in many areas of study and is a key consideration in business needs throughout the world. Books in this series expose the theoretical underpinning behind the law to shed light on taxation systems, so that the questions to be asked when addressing an issue become clear. These academic books, written by leading scholars, are a central port of call for information on tax law, with content illustrated by case law and legislation. The books will be of interest to those studying law, business, economics, accounting and finance courses.

Series Editor
Professor Peter Harris
Law Faculty, University of Cambridge, Director of the Centre for Tax Law.

Professor Harris brings a wealth of experience to the series. He has taught and presented tax courses at more than a dozen different universities in as many countries and has acted as an external tax consultant for the International Monetary Fund for over twenty years.
European Union Corporate Tax Law

Second Edition

CHRISTIANA HJI PANAYI

Queen Mary University of London
To my children – Maria, Nikos and George
# Contents

Foreword to the First Edition by Malcolm Gammie QC  page xi
Foreword to the First Edition by Michael Lang  xv
Foreword to the Second Edition by Philip Baker  xvii
Preface to the First Edition  xix
Preface to the Second Edition  xxi

1  A Historical Trajectory of EU Corporate Tax Law  1
   1.1 Introduction  1
   1.2 The Historical Background  6
      1.2.1 The Neumark Report  6
      1.2.2 The Segrè Report  8
      1.2.3 The Programme for the Harmonisation of Direct Taxation  9
      1.2.4 The Van den Tempel Report  10
      1.2.5 The Commission’s 1975 Proposal and Its Aftermath  11
      1.2.6 The Ruding Report  14
   1.3 Harmful Tax Competition and the Tax Package  15
   1.4 The 2001 Company Tax Study  17
   1.5 The Aftermath to the 2001 Company Tax Study  19
   1.6 The BEPS and Post-BEPS era: The Rise of Tax Good Governance and Fair Taxation  21
      1.6.1 Good Governance in Tax Matters and the Development of the EU’s External Fiscal Policy  22
      1.6.2 EU List of Non-Cooperative Jurisdictions  27
      1.6.3 Tax Good Governance and Fair Taxation as a Prelude to Comprehensive Tax Reform  29
      1.6.4 The Brexit Saga  31
   1.7 The Future of EU Corporate Tax Law  34
Contents

2 EU Corporate Tax Legislation

2.1 The Parent-Subsidiary Directive

2.1.1 Profit Distribution

2.1.2 Eligibility Requirements

2.1.3 Taxing the Profit Distribution

2.1.4 What Is a Withholding Tax?

2.1.5 Tax Avoidance and the Parent-Subsidiary Directive

2.2 The Merger Directive

2.3 The Interest and Royalties Directive

2.3.1 Eligible Companies, Permanent Establishments and Beneficial Ownership

2.3.2 Interest, Royalties and Excluded Payments

2.3.3 The Taxation of the Payer/Debtor

2.4 The Arbitration Convention

2.5 The Tax Dispute Resolution Mechanisms Directive

2.6 The Anti-Tax Avoidance Directive

2.7 Directives on Mutual Assistance and Tax Transparency

2.8 Pending Legislative Proposals

2.8.1 The CCTB/CCCTB

2.8.2 The Financial Transaction Tax

2.8.3 Proposals for Taxation of the Digital Economy

3 The Court of Justice and the Development of EU Corporate Tax Law

3.1 Tax Litigation in the Court of Justice

3.2 Fundamental Freedoms and Direct Taxation

3.2.1 Free Movement of Goods

3.2.2 Free Movement of Persons

3.2.3 Freedom to Provide Services

3.2.4 Free Movement of Capital

3.3 Methodology of the Court of Justice

3.3.1 Finding the Relevant Freedom

3.3.2 Discrimination and Restriction Approach

3.3.3 Tax Treaties and Double Taxation

3.3.4 Overall or Per-Country Approach?

3.4 Conclusion

4 Tax Obstacles to the Cross-Border Movement of Companies: Direct Investment

4.1 Company Residence

4.2 Issues with the Taxation of Corporate Groups

4.2.1 Expenses in Foreign Holdings

4.2.2 Cross-Border Loss Relief

4.2.3 Controlled Foreign Companies

© in this web service Cambridge University Press www.cambridge.org
Contents

4.3 Issues with the Taxation of Permanent Establishments 162
   4.3.1 Defining Permanent Establishments 162
   4.3.2 The Different Treatment of Permanent Establishments and Companies 163
   4.3.3 Rules for the Attribution of Profits and Expenses 170
   4.3.4 Notional Payments and Expenses 174
   4.3.5 Cross-Border Loss Relief 177

5 Tax Obstacles to Cross-Border Portfolio Investment 193
   5.1 Double Taxation Relief Mechanisms 193
   5.2 The Taxation of Inbound Dividends 197
      5.2.1 The Early Cases: Individual Shareholders 198
      5.2.2 Later Cases: Corporate Shareholders 200
      5.2.3 Economic and Juridical Double Taxation – The Home State Perspective 213
   5.3 The Taxation of Outbound Dividends 216
      5.3.1 The Early Cases 216
      5.3.2 Later Cases – Consolidation of the Court’s Principles 220
      5.3.3 The Relevance of Tax Treaties – Neutralisation of Host State Taxes? 232
      5.3.4 Economic and Juridical Double Taxation – The Host State Perspective? 236
      5.3.5 Taxation on Gross Basis or Net Basis and Other Deductions 238
      5.3.6 Other Developments 243
   5.4 The Taxation of Interest and Royalties 245

6 Reorganisations under EU Tax Law 249
   6.1 Corporate Reorganisations and the Merger Directive 250
      6.1.1 The Scope of the Merger Directive 250
      6.1.2 Reliefs under the Merger Directive 253
      6.1.3 Case Law on the Merger Directive 256
   6.2 Corporate Migration and Exit Taxes 269
      6.2.1 Exit Taxes 269
      6.2.2 The Early Exit Tax Cases on Individuals 272
      6.2.3 The National Grid Indus Case and Its Aftermath 275
      6.2.4 The Exit Tax Provision of the Anti-Tax Avoidance Directive 286
   6.3 Transfer of Assets Within the Same Company 288

7 Tax Avoidance and EU Law 291
   7.1 An EU Principle of Abuse of Tax Law? 291
   7.2 Controlled Foreign Companies 297
      7.2.1 CFCs in EU Tax Case Law 298
Contents

7.2.2 CFCs and the Anti-Tax Avoidance Directive 306
7.3 Interest Deductibility Restrictions 310
  7.3.1 Thin Capitalisation in EU Tax Case Law 311
  7.3.2 Interest Deductibility Limitation Rule and the Anti-Tax Avoidance Directive 320
7.4 Transfer Pricing 322
7.5 Other Anti-Abuse Provisions 328

8 State Aid and Taxation 331
  8.1 Introduction 331
  8.2 The Role of the Commission and Member States 336
  8.3 The Role of National Courts 337
  8.4 State Aid and Taxes 339
  8.5 Tax Rulings, Advance Pricing Agreements and State Aid 346
    8.5.1 The Belgian Excess Profits Regime 348
    8.5.2 The Starbucks and Fiat Investigations 350
    8.5.3 The Apple Investigation 353
    8.5.4 The McDonald’s Investigation 357
    8.5.5 Other Investigations 359

9 EU Corporate Tax Law: More Interim Conclusions and Thoughts 361
Foreword to the First Edition by Malcolm Gammie QC

For more than fifty years the European Project, currently incarnated as the European Union, has struggled with the issues of corporate taxation. At an early stage the European Commission recognised that, in an ideal world, Member States should address these issues. So long as two or more states are engaged in a project to create a single market, national taxation of corporate profits is likely to present an obstacle to that project. The production of a single market system for taxing corporate profits raises a number of significant difficulties, however. The corporate tax is in effect a compromise: a surrogate, or an essential backstop, for the national system of taxing personal income. As a result, the corporate tax is likely to be tailored to the policies and priorities of national taxes on income. Nowhere is this more apparent than in the choices that states make for taxing company dividends. Dividend taxation systems link the corporate and personal tax systems and are the mechanism through which states integrate the two. They can be designed to reduce the distortion in financing via debt and equity by matching the deductibility of interest in computing profits with a credit for the corporate tax paid on profits, or by conferring a partial or complete dividend deduction or exemption.

At the same time, the jurisdictional limits of national taxation demand as a practical matter that states draw a line between what is national or domestic and what is international or cross-border. The international corporate tax system is founded on concepts of residence, of arm’s length transfer pricing and of crediting foreign tax or exempting foreign income. At the same time cross-border taxation of dividends works on a classical basis, under which the residence country taxes profit distributions without regard to the source country’s taxation of the profits. The economic and juridical taxation that results, and the distortion that these taxes produce in comparison to debt finance, are likely to be significant barriers to cross-border investment and the single market. None of these are ordinarily found as features of a true single market, where ‘residence’ in a particular place in the market is irrelevant and where sub-national taxing jurisdictions more likely operate on

1 I include dividend taxation as part of corporate taxation.
a territorial basis, with formulary apportionment as necessary, and do not assert any right to tax dividends. The publication by the European Commission in 1975 of a Draft Directive for the harmonisation of dividend taxation on an ‘imputation’ model attracted the attention of those in the United Kingdom with an interest in these matters. The UK had adopted a partial imputation system in 1973, abandoning its 1965 classical system and reverting more closely to its pre-1965 model. In the context of the UK’s recent entry to the European Economic Community, it seemed as though the UK had made the correct choice and had charted a course compatible with the future development of an EEC corporate tax system.

As with other Commission initiatives, the 1975 Draft Directive came to naught and was finally withdrawn in April 1990. Indeed, the core problem from the outset with any Commission initiative was the failure of governments to truly engage in whatever debate then ensued. It would be many years before this changed. The pressures of the developing single market on corporate and dividend tax systems were not, however, going to abate and work by the Institute for Fiscal Studies drew attention to the importance of addressing the distortions created for cross-border investment by dividend withholding taxes.\(^2\) It was against that backdrop and the preparations for the ‘completion’ of the single market from 1993 that the Member States adopted the French package of measures in Dublin on 11 June 1990. In 1990 the Commission also appointed the Ruding Committee to consider the fundamental issues that corporate tax systems raised for the single market. This represented the high-water mark at the time and, for some, offered renewed optimism for future progress; an optimism that was soon dashed by Member States’ reaction to the Ruding Committee Report in 1992. It would take until the early 2000s before the Commission, led by Commissioner Mario Monti, would pursue with any real vigour the possibility of radical corporate tax measures.

The real development that was emerging in the mid-1990s, however, was the jurisprudence of the European Court of Justice. In 2012 it is easy to forget how irrelevant Community law was to daily corporate tax practice until well into the 1990s. From early beginnings in the 1986 **Avoir Fiscal** case,\(^3\) concerning dividend imputation, references from national courts gathered pace throughout the 1990s and into the new millennium. This enabled the Court, with the benefit of the judicial activism of judges such as Michel Wathelet of Belgium and David Edwards of the UK, to assert the priority of the treaty freedoms over national tax systems that discriminated as a matter of course between the national and domestic and the international and cross-border. The extension of a restriction-based analysis to the tax sphere guaranteed the need for governments to take note of the impact of these developments on their tax systems and to reassess fundamentally their approach to


\(^3\) Case 270/83, Commission v. French Republic, EC Court of Justice, 28 January 1986.
and their engagement with the debate on corporate tax systems within the single market.

It is against this backdrop that Christiana HJI Panayi has reviewed the efforts of more than fifty years to achieve some rational progress in the corporate tax field and considers the limited corporate tax measures that have been adopted or are under discussion. A significant part of her book, however, is taken up with an analysis of the current case law and its implications for corporate taxation. The basic parameters set by the case law within which Member States can legislate in the corporate tax field are now relatively clear. There nevertheless remains substantial scope for analysis by commentators such as the current author to elucidate and cast light on the significant number of cases that now exist. Without political agreement on the role and direction for corporate taxes within Europe, Member States are left to strike the right balance between those matters within their competence and those that lie within the sphere and competence of the European Union. There is an ongoing need for expert criticism and commentary on their efforts. Progress in the corporate tax sphere may no longer be ‘glacial’, but it may yet be some years before the current author can limit her task in a future edition scribing and analysing a single European corporate tax system.

Malcolm Gammie QC

Foreword to the First Edition by Michael Lang

Tax law is still within the competence of the Member States. However, European Union law has become quite important. The Court of Justice of the European Union has become an important player. Before 1986 probably only a few experts had foreseen which limits the Court of Justice would put on the legislation of the Member States. In the meantime the Court has rendered hundreds of decisions. Today it is fair to say that the Court has developed common rules that serve as a framework for Member States. Judges who are interpreting their domestic law in the various Member States have no choice other than to take European Union law into account when rendering their decisions.

Since the Court of Justice of the European Union can only act as a ‘negative legislator’, the European Commission has tried to propose ‘positive legislation’. In the meantime the European legislator has introduced some directives in the area of direct taxation that are part of European secondary law. Those directives do not have a broad scope yet and the Commission has started to propose new initiatives. In the area of corporate tax law the proposal for a CCCTB has become very important.

Christiana HJI Panayi has made the effort to not only collect all the rules and decisions that are relevant in the area of corporate taxation, but has also tried to bring all of the rules into a system and to describe that system in an understandable way. This task has been very successful and Christiana has written an extremely interesting book. She discusses European primary law as well as European secondary law. What is fascinating is the fact that it is much easier to see the full picture having read the whole book. At the same time she points to the open issues that cannot Court of Justice of the European Union alone, but which need the action of the European legislator.

Therefore, I hope that not only will students and practitioners study the book, but that policy-makers all over Europe will make use of her research and will draw the conclusion that greater harmonisation is needed in the area of corporate tax law.

Michael Lang
Foreword to the Second Edition by Philip Baker

I am delighted to have been asked to write the foreword to this second edition of Christiana HJI Panayi’s extremely readable book on European Union Corporate Tax Law. It is a great pleasure to be able to recommend this book. It is interesting to note at the outset that in the mid-1980s there was just about enough material to discuss on European Community tax law to merit a half course in the London LLM degree: now the topic of EU corporate direct taxation merits a book all of its own (and a second edition at that).

This is the second edition of the book that first appeared in 2013. The new edition updates materials to the end of August 2020. This includes the most recent cases from the Court of Justice of the European Union, including the decisions on state aid in FIAT, Starbucks and Apple, the last of which appeared in mid-July 2020. Other recent material added to the book includes a brief discussion of Brexit, the Tax Dispute Resolution Mechanism Directive, the Anti-Tax Avoidance Directive and the judgments in the Danish beneficial ownership cases.

The update of the contents to the end of August 2020 is particularly helpful to those in the United Kingdom: as a consequence of the ending of the Implementation Period for Brexit in the United Kingdom, effectively a ‘snapshot’ is to be taken of EU law as at the end of 2020. This snapshot of the law will continue as ‘retained EU law’ until displaced by legislation or by new, UK case law. In that context, this book – not quite stating matters as at the end of 2020, but very close – will prove to be particularly useful and may have a particularly long shelf life. We will be referring to it for some time to see where EU direct, corporate taxes had reached by late 2020.

Earlier books on EU tax law have tended to structure the material around each of the basic freedoms. This book follows the more recent approach, which is to order the material around particular topical issues. After an initial chapter on the historical background to EU corporate tax law, the second chapter focuses on the limited amount of corporate tax legislation, including some of the pending legislative proposals for a CCTB/CCCTB, a financial transaction tax, and the proposal for...
taxation of the digital economy. Chapter 3 then focuses on the role of the Court of Justice in the development of EU corporate tax law and explains how cases reach the Court. The next two chapters then look at cross-border transactions of companies from the point of view first of direct investment (including cross-border loss relief, controlled foreign companies, and issues related to permanent establishments) and then cross-border portfolio investment, particularly focused on inbound and outbound dividends. A chapter on reorganisations under EU tax law includes both cross-border mergers and a detailed examination of the exit tax case law. Quite novel in this area is a chapter on tax avoidance and EU law, including discussion of controlled foreign companies and transfer pricing. Finally, in terms of substantive chapters, there is a discussion of state aid and taxation. This is, of course, the biggest growth area in the field of EU law and taxation over the last 20 years, and the book includes the latest decisions.

As the author explains, the limited competence of the European Union in the field of direct taxation has meant that much of the development has taken place by way of negative harmonisation through decisions of the Court of Justice, and through the development of soft law instruments. On the case law, the book is particularly rich, with references to all the leading cases, and will prove a particularly useful guide, particularly, as explained, on the position of case law as at the latter part of 2020. Much of this case law and soft law is set in the context of the general principles of international taxation: how those principles provide a backdrop to the EU rules, and how those EU rules depart from international tax rules as they apply between countries that are not members of the European Union.

It has been seven years since the previous edition of the book (during which the arrival of three children no doubt diverted the author’s attention away from a new edition). Given the speed of development of EU tax law, particularly with regard to corporations, there is every reason to expect that this book will continue to appear in new editions on a regular basis in future years. The author of this foreword anticipates that it will probably be less than five years before developments in case law and legislation prompt the author to produce a third edition (assuming no more children come along to divert her attention!).

There is one point to note for future editions. It is reasonable to project that the next edition will include a separate chapter on the protection of taxpayers’ rights, with particular reference to the growing case law of the Court of Justice on the application of the Charter of Fundamental Rights, including its application to corporate taxpayers.

This is a readable and enjoyable book, which has no doubt benefited tremendously from the author’s lecturing on EU tax law. I am delighted to welcome this book into the growing collection of excellent texts – books and articles – written by the author.

Philip Baker QC
Field Court Tax Chambers
Gray’s Inn
Preface to the First Edition

I decided to write this book after many years of teaching international tax law and EU tax law at Queen Mary, University of London and many years of research in this field. I assumed it would be easy to write a book that combines the two topics in examining the corporate angle to the tax developments in the European Union. I also assumed it would be easy to write this book while on maternity leave, after having my first child. Both of these assumptions proved wrong.

There was an enormous amount of material to be covered and the case law of the Court of Justice, especially the more recent one, was very challenging. The interplay with the OECD Model and general international tax law was always a source of potential conflict, generating interesting developments. The changes were fast-paced and often unpredictable. Trying to discern the past, present and future of EU corporate tax law was certainly not an easy task.

In writing the various chapters, I often found myself rereading old cases and gaining a different perspective from the one I had initially. I also developed a better understanding of endogenous changes in the case law in various areas. Some of the judgments were, however, completely perplexing – an indication of what I thought was the uneasiness of the Court of Justice in dealing with certain issues. Nevertheless, my admiration for the Court of Justice and its work in this area grew. The fact that today we have a developing body of principles that form what could be considered as the corporate tax law of the European Union is mostly attributable to the Court of Justice, as well as the Commission and national courts that trigger the European judicial process. The book depicts these themes and discusses the existing principles of EU corporate tax law.

This book would not have been written had it not been for my family. I would like to thank my husband Zak Palexas for his continuous inspiration, support and encouragement. I would also like to thank my parents for their help and the endless hours of babysitting they had to endure in order for me to be able to complete the
Preface to the First Edition

book on time. Most of all I would like to thank my daughter Maria for her patience in
becoming so heavily involved in the tax world at such a young age. The number of
times she shook her head in disbelief, deleted paragraphs from the draft and tore up
papers lying around is perhaps an indication that the current state of the law is in
need of some improvement. It is hoped that future editions of this book will reflect
that.
Preface to the Second Edition

The first edition to this book was met with enthusiasm and positive comments. I had been postponing the second edition to this book for some time. There was always so much going on in the EU, so my natural inclination was to let the dust settle before writing a second edition.

However, when there is a constant hurricane of developments, the dust never settles. Therefore, I eventually started working on the second edition to this book in February 2020, after the UK’s exit from the EU. In some regards, my timing could not have been worse, as due to the global pandemic, I soon found myself in lockdown with three energetic small children with very little appetite for home schooling. However, from another perspective, my timing could not have been better, as it became obvious that in this historical point in time the EU had come to a crossroad – its overall existence and raison d’être were being debated and had to be justified. I felt it was crucial to capture this moment in the context of EU corporate tax law and offer my thoughts.

Special thanks to Joy Svasti-Salee, Philip Baker, Katerina Perrou and Dimitrios Kyriazis for the insightful comments on earlier versions of this manuscript. All errors are of the author, of course.

The contents of this book are based on materials available up to 1 August 2020.