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

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I. General Overview

A. Background

1 The founding of three communities in the 1950s initiated a process that would eventually lead to the establishment of the modern European Union. They were: the European Coal and Steel Community, the European Economic Community, and the European Atomic Energy Community. The European Coal and Steel Community was formed for only a period of 50 years and ceased to exist in 2002. The European Economic Community was established by the European Economic Community Treaty signed in Rome on 25 March 1957 and is also known as the EC Treaty. The European Atomic Energy Community was established by the treaty establishing the European Atomic Energy Community on 25 March 1957 (hereinafter EAEC Treaty). The European Union was not established until 1992 by the means of the Treaty of Maastricht (hereinafter TEU) which placed all of the communities under one umbrella of policies and forms of cooperation. Subsequently, the Treaties of Amsterdam and Nice entered into force in 1999 and 2003, respectively, reforming the EU institutions. The subsequent project of an EU constitution in 2005 was struck down after referenda in France and the Netherlands failed to gain a majority. Instead, an attenuated version was adopted with the Treaty of Lisbon (which was agreed to in 2007 and entered into force in 2009). Among various changes, the Treaty of Lisbon merged the EU and the European Community (previously the European Economic Community) into the "Union". It also subjected the actions of the EU institutions and the Member States insofar as they apply and implement EU law to the Charter of Fundamental Rights of the European Union (hereinafter the Charter of Fundamental Rights or the Charter) which enshrines certain fundamental rights that are legally binding at the EU level.

2 As a result, the following four instruments form the foundation of the EU legal system: TEU,[1] TFEU[2] (which is an updated version of the EC Treaty), EAEC Treaty (updated version), and the Charter. Together, the Treaties and the Charter form EU primary law. An inherent aspect of EU primary law is the general principles on which the EU legal system is based. They play a key gap-filling role that ensures the coherence of the EU legal system and are taken into account when EU law as well as national law measures are interpreted.[3] EU primary law is supplemented by secondary law which is law made by the EU institutions in the exercise of the powers conferred on them by primary law. It consists of the following legislative acts (Art 288 TFEU):

1 Consolidated version of the Treaty on European Union, OJ C 326 of 26 October 2012.
2 Consolidated version of the Treaty on the Functioning of the European Union, OJ C 326 of 26 October 2012.
3 Lenaerts/Gutiérrez-Fons, The Constitutional Allocation of Powers and General Principles of EU Law, *Common Market Law Review* 47/6 2010, pp. 1629–1669.

- Regulations: Regulations in the EU apply automatically and uniformly to all EU countries as soon as they enter into force. There is no need for any transposition into domestic law.
- Directives: Directives set certain results that have to be achieved by Member States. The Member States themselves must implement appropriate measures to achieve these goals within a certain timeframe. Due to their precise and unconditional nature, they may be self-executing (see m.no. 17).
- Decisions: A decision is a binding legislative act by the Commission. It also needs no transposition into domestic law and, according to its specifications, it may only apply to certain individuals or states.

Another important element of the EU legal system is the general legal principles[4] that determine the lawfulness of administrative and legislative measures within the EU. Therefore, they may act as an instrument when pursuing "negative integration". "Negative" integration describes the prohibition of illegitimate obstacles in the way of the four freedoms or the general principles, respectively (see also m.no. 25). Meanwhile, "positive" integration that implies policy integration (i.e. integration through legislation) plays an important role as well. Additionally, the EU makes use of soft law that consists of non-legislative acts (recommendations, opinions, etc.). In addition, the case law of the CJEU and international Treaties signed by the EU are also considered to be a part of the EU legal system.

3 The fundamental core of the EU legal system is the concept of an internal market. It is defined in Art. 26 TFEU as "*an area without frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of the Treaties*". The obvious goal is to achieve the economic integration of the Member States and thus generate more wealth and prosperity throughout the Union. Achieving an internal market depends on the four freedoms: the free movement of goods, capital, services, and labour. In addition to the four freedoms, the prohibition on cartel agreements, abuse of dominant market position, and state aid prohibition are also aimed at ensuring the protection of the internal market. All of this highlights that the major driver for EU legal action lies within the economic shere. The non-economic component of European integration has a weaker legal basis for supranational action which, in turn, has important repercussions in the absence of a common supranational policy, such as in the field of taxation.

4 Taxation is often rather seen as a potential obstacle to achieving a harmonized internal market and, as a result, is susceptible to infringing the fundamental freedoms. It may distort competition. This is the main reason for a number of directives and regulations in the area of taxation in the EU. However, harmonisation has only been achieved in the field of indirect taxes whereas direct taxation is still

4 E.g. the principle of equal treatment, see CJEU, 22 November 2005, Case C-144/04, *Werner Mangold v. Rüdiger Helm*, ECLI:EU:C:2005:709.

V. Overview of the Functioning of the Directive

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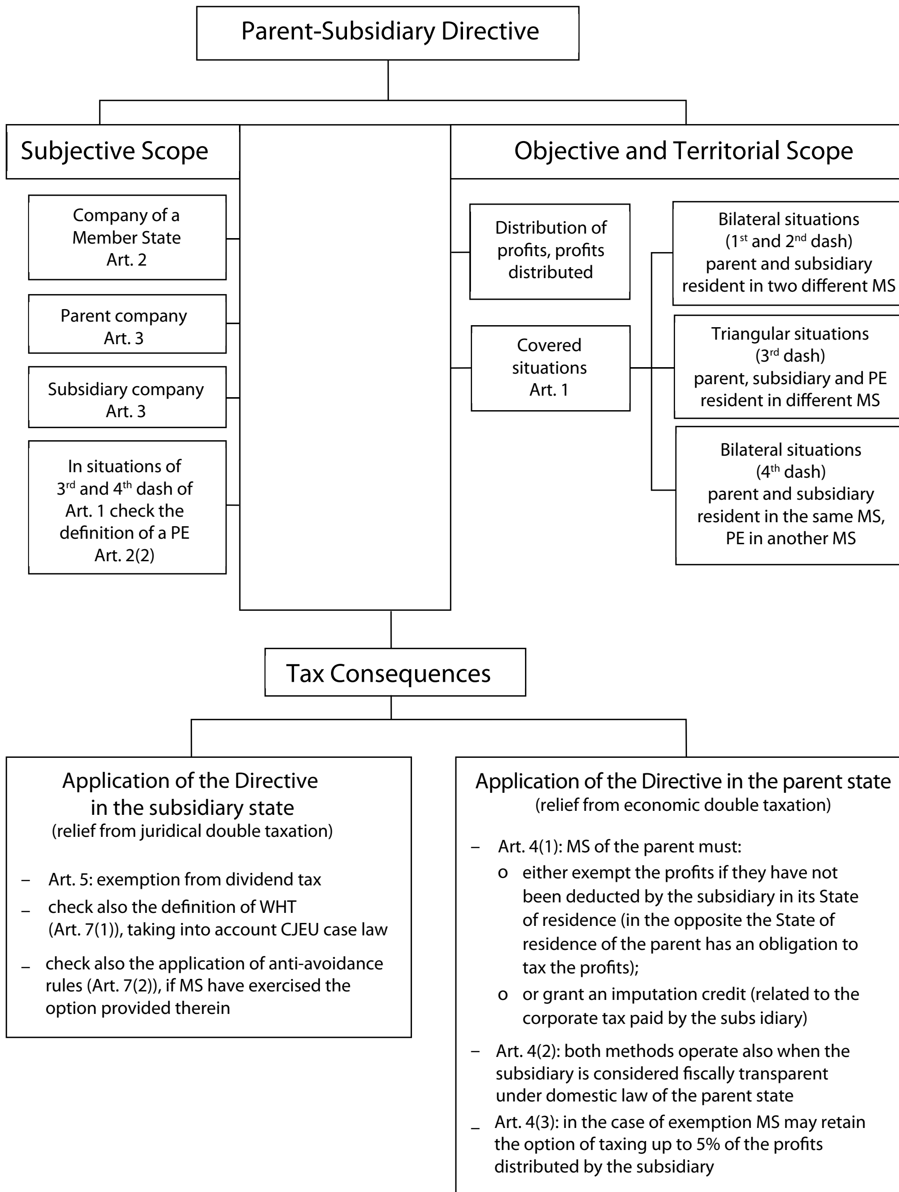

Chapter 6 – The Merger Directive

Matthias Hofstätter/Daniela Hohenwarter-Mayr

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I. The Necessity of Tax-Neutral Reorganizations in the European Union

439 **Reorganizations** – in absence of any specific tax provisions – will generally **trigger taxation of capital gains as barter-like transations.** For **domestic reorganizations** Member States typically provide for a deferral of the capital gains tax levied on the hidden reserves of the transferred assets under their domestic tax law. Often, losses not yet utilized by the transferring company may also be carried over to the acquiring company. Therefore, domestic reorganizations are tax neutral, i.e. they do not trigger immediate taxation at the time of the reorganization since taxation of the capital gain is deferred until a later disposal of those assets.

440 Similar tax provisions for **reorganizations of companies of different Member States** are necessary for the completion of an internal market within the European Union. Thus, cross-border reorganizations ought not to be hampered by restrictions, disadvantages or distortions arising from the tax provisions of the Member States. It is therefore necessary to have tax provisions that are neutral from the point of view of competition in order to allow enterprises to adapt to the requirements of the common market, increase their productivity and improve their competitive strength at the international level. Consequently, tax provisions that put cross-border reorganizations at a disadvantage in comparison with reorganizations involving companies established in the same Member State have to be abolished.

441 However, it was considered that simply extending the rules for domestic reorganizations to cross-border reorganizations was not feasible because of the differences between the regimes in force in the Member States. (New) distortions were expected. Only a **common tax system for cross-border reorganizations** was thought to provide a satisfactory solution. Therefore, the Council adopted the 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 (hereinafter the Merger Directive or Directive).[1]

442 The **aim** of the common tax system for cross-border reorganizations is to **avoid the imposition of an income or capital gains tax** in connection with mergers, divisions, partial divisions, transfers of assets, exchanges of shares and transfers of the registered office of an SE or SCE between Member States. At the same time, the **financial interests of the Member State** of the transferring or acquired company should be safeguarded. Thus, the taxing rights of the Member States should be protected.

443 Initial proposals for a Merger Directive date back to 1969. However, it took more than 20 years before the final text was **adopted by the Council in 1990**. In 2003

1 Now 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 (codified version), OJ L 310 of 25 November 2009, pp. 34–46.

the Commission issued a **proposal to** substantially **amend the Directive**,[2] a modified version of which was finally **adopted by the Council in 2005**.[3] The changes in 2005 included a **broadening of the personal and the objective scope** of the Directive. The personal scope was enlarged to include the SE, the SCE and several entities previously not covered, as well as hybrid entities.[4] With respect to the objective scope, partial divisions and the transfer of the registered office of an SE or SCE from one Member State to another were included. Because of the numerous amendments in the meantime,[5] the Merger Directive was codified **in 2009** to enhance clarity and rationality.[6] However, the **codification** did not lead to changes in terms of content.

II. Scope

A. Personal Scope

444 The Merger Directive requires the companies involved in the operations covered[7] to qualify as a "company from a Member State". To be characterized as a "company from a Member State" the respective company has to meet **three requirements**: Firstly, the company has to take one of the legal forms listed in the annex to the Merger Directive. Secondly, the company has to be resident, for tax purposes, within the European Union. Thirdly, the company has to be subject to one of the taxes listed in the annex to the Merger Directive.

445 With respect to the first requirement (Art. 3(a)), the company has to take **one of the legal forms listed in the annex** to the Merger Directive. Under the 2005 amendment, the list of eligible legal forms was considerably enlarged. Nevertheless, not all companies qualifying as companies for domestic corporate income tax purposes qualify as companies under the Merger Directive.

446 The second requirement is that the company has to be **resident for tax purposes in one Member State** on the basis of the **domestic tax law** of that State. Additionally, the company must not, according to a **double taxation convention (DTC) concluded with a third State** (non-Member State), be resident for tax purposes

2 COM(2003) 613.

3 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, OJ L 58 of 4 March 2005, pp. 19–26.

4 For the tax treatment of hybrid entities in the context of operations covered by the Merger Directive see Fibbe/Stevens, *Hybrid Entities and the EU Tax Directives* (2015), p. 18 et seq., as their treatment will not be further elaborated on in this chapter.

5 E.g. Council Directive 2006/98/EC of 20 November 2006 adapting certain Directives in the field of taxation, by reason of the accession of Bulgaria and Romania, OJ L 363 of 20 December 2006, pp. 129–136.

6 After the codification in 2009 the Merger Directive was amended in the course of Croatia's accession to the EU; Council Directive 2013/13/EU of 13 May 2013 adapting certain directives in the field of taxation, by reason of the accession of the Republic of Croatia, OJ L 141 of 28 May 2013, pp. 30–31.

7 See m.no. 449 et seq.

Chapter 9 – The Global Minimum Taxation Directive

Franz Wallig

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VI. Overview of the Directive

I. Introduction

A. Background and Overview

593 The advancing digitalization and globalization has changed the global economy and business models around the world in the 21st century. To address the tax challenges of this time, the OECD/G20 Inclusive Framework, among other projects, presented a **two-pillar solution** to the public in 2019. While Pillar I tries to establish a new system for profit allocation between states to accommodate new digital business models, Pillar II tackles the issue of global base erosion by introducing a new internationally agreed upon minimum tax rate. At the time of publication, it seems unlikely that Pillar I will come into effect as it would need

the political support of the United States.[1] However, the Inclusive Framework finished the main work on Pillar II in 2022, releasing the so-called OECD Model Rules in December 2021 and the corresponding commentary early in the following year. Since then, the OECD has published administrative guidance and further information on safe harbour rules to promote the effective and efficient implementation of Pillar II.

594 Pillar II is designed to ensure that large MNE groups and large-scale domestic groups pay a **minimum level of tax of 15%** on the income arising in each jurisdiction where they operate. To establish a uniform reference of when this minimum tax level is achieved, Pillar II had to define a common base to measure an MNE groups achieved level of taxation. The whole framework is therefore based on financial accounting rules that are less prone to amendments by domestic tax legislation. In fact, Pillar II is based on the consolidated financial reports of an MNE group which defines the group's scope. The individual financial statements prepared for consolidation of the groups individual entities are then the starting point of the global minimum taxes tax base determination. However, due to deviations in accounting and tax principles, Pillar II requires certain adjustments to be made to the financial accounting figures. The adjustments provided in Pillar II are applied to the financial accounting net income or loss (FANIL) of the in-scope constituent entities to arrive at the net qualifying income of the entities. In addition, the in-scope constituent entities have to determine the taxes attributable to their net qualifying income. These numbers are aggregated for each jurisdiction (jurisdictional blending) to determine the effective tax rate (ETR) of the jurisdiction. If the ETR is below 15%, a top-up tax percentage has to be determined amounting to the difference between the ETR and the minimum tax rate of 15%. This top-up tax percentage is applied to the net qualifying income of the jurisdiction reduced by a substance-based income exclusion to take into account genuine business activity in the jurisdiction. Finally, this jurisdictional top-up tax is allocated back to the constituent entities and imposed by the MNE group or large-scale domestic group. Pillar II includes a three step mechanism to determine how the top-up tax is to be levied. First, the Member States may introduce a qualified domestic minimum top-up tax (QDMTT) to impose the top-up tax by themselves. If there is no QDMTT in place, the income inclusion rule (IIR) applies, attributing the liability to pay the top-up tax, as a rule, to the highest level parent entity whose jurisdiction applies an IIR (top-down approach). Any remaining amount of top-up tax is allocable under the undertaxed profit rule (UTPR). The workings of these rules will be explained in further detail below. Finally, Pillar II contains a number of special provisions dealing with specific issues (e.g. minority owned entities or investment funds). These special provisions are not covered in this introduction.

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1 See, for example, Avi-Yonah, *Pillar 2 and the United States: What's Next,* TNI 2023, p. 619.

B. International State of Implementation

The European Union is a strong supporter of the OECD's work and committed itself to a swift introduction of the new rules shortly after the publication of the OECD Model Rules.[2] It delivered on this commitment by publishing the **Global Minimum Tax Directive (GMTD)** on 14 December 2022 in the Official Journal of the EU.[3] The Member States had to transpose the GMTD into domestic law by 31 December 2023, and it became applicable for fiscal years beginning from this date. Eighteen Member States transposed the GMTD into national law on time[4] while nine Member States did not do so.[5] The GMTD also provides for an election for a delayed application of the IIR and UTPR for Member States with fewer than 12 in-scope ultimate parent entities (UPE), which was exercised by five Member States.[6] **595**

Contrary to the comparatively fast **progress** with Pillar II in the EU, the transposition of Pillar II into domestic law at the **international level has been slow**. Many countries are currently still considering whether they should introduce the rules at all or have decided to only introduce a QDMTT.[7] Only a minority of countries outside of Europe, like Canada[8] and New Zealand,[9] have already moved forward with the transposition of Pillar II into domestic law. Especially the United States, which was on the forefront of the discussions on the two pillars, has yet to introduce the rules. This could be achieved by somewhat amending the recently introduced tax measures of GILTI and BEAT that try to achieve similar goals as Pillar II.[10] This was already suggested by a bill brought forward by the **596**

2 Recital 3 of the Directive.

3 COUNCIL DIRECTIVE (EU) 2022/2523 of 14 December 2022 on ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups in the Union, Abl L328/1.

4 Austria, Belgium, Bulgaria, Croatia, the Czech Republic, Denmark, Finland, France, Germany, Hungary, Ireland, Italy, Luxembourg, the Netherlands, Romania, Slovakia, Slovenia, and Sweden.

5 Cyprus, Estonia, Greece, Latvia, Lithuania, Malta, Poland, Portugal, and Spain. See also: European Commission, *Commission takes action to ensure complete and timely transposition of EU directives*, https://ec.europa.eu/commission/presscorner/detail/en/inf_24_286 (accessed on 8. February 2024).

6 Estonia, Latvia, Lithuania, Malta, and Slovakia. See also Commission Notice: Election to delay application of the IIR and UTPR under Art. 50 of the Pillar Two Directive, C/2023/1536.

7 See, for example, Herzfeld, *Cruising the World With Pillar 2,* TNI 2023, p. 1053.

8 Canada published the draft legislation for Pillar II in 2023: Legislative Proposals Relating to the Global Minimum Tax Act, accessible under https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=&cad=rja&uact=8&ved=2ahUKEwjRluHOrpyEAxX9-wIHHZi_B6UQFnoECDQQAQ&url=https%3A%2F%2Ffin.canada.ca%2Fdrleg-apl%2F2023%2Fita-lir-0823-l-4-eng.pdf&usg=AOvVaw0i8tlm1nyeVnoLuvokv1UL&opi=89978449.

9 See Soong/Stephanie, *New Zealand Proposes Global Minimum Tax Rules to Start in 2024,* TNI 2023, 1109.

10 See in detail, for example, Herzfeld, *Debate on the US Tax Reform and the EU ATAD: Can GILTI + BEAT = GLOBE?* TAXI 2019, p. 504; Blum, *Debate on the US Tax Reform and the EU ATAD: The Proposal for a Global Minimum Tax: Comeback of Residence Taxation in the Digital Era?: Comment on Can GILTI + BEAT = GLOBE?* TAXI 2019; Herzfeld, *Article: Do GILTI + BEAT + BMT = GloBE?* TAXI 2022, p. 514.