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Merger of the Concepts of Selectivity and Non-Discrimination in Fiscal State Aid Law

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Abstract

EU Member States are increasingly considering unobtrusive and indirect ways of attracting and financing companies in the form of tax incentives and concessions, thereby stimulating tax competition. Given today's trend towards digitalisation and globalisation, companies are steadily operating on an international level, exploring business opportunities. The strict State aid control sought by the EU, particularly the EU Commission, is not only aimed at national direct tax laws, but also at individual measures. A central problem of the ever-expanding State aid control of tax measures is that it is not possible to predict whether a measure will be categorised as incompatible with the internal market. This leads to legal uncertainty for national legislators and affected companies. At the same time, this uncertainty can seriously undermine the tax autonomy of States. In order to resolve conflicts jurisdiction and create more legal certainty, State aid control must be focussed on the actual purpose of the State aid rules. This includes the avoidance of cross-border trade distortions and the associated unequal treatment. Such a reorganisation would be in the interest of a uniform development of EU law.

One of the EU's main objectives is the realisation of the single market with the free movement of capital, labour, technology and companies between the Member States. The rules on State aid also aim to strengthen the internal market by combating market and competition distortions caused by State intervention. The question of selectivity is at the centre of the analysis of tax aid, as the other conditions of Article 107(1) TFEU are generally fulfilled or deemed to be fulfilled and therefore do not need to be examined in detail. Furthermore, the Commission and the Court of Justice of the European Union do not analyse aid measures according to their form, but according to their effects. In this respect, the Commission, as guardian of the Treaties, has gradually introduced a number of soft law instruments and continues to do so in order to further structure its approach to State aid law.

Not only the rules on State aid, but also the provisions of the Treaty on the fundamental freedoms prohibit jeopardising free competition in the internal market. Serving the same purpose, they safeguard undistorted competition with a level playing field for all economic operators and thus constitute an effective instrument for promoting European fiscal integration. The fundamental freedoms are all based on the principle of non-discrimination. They do not distinguish between general and selective tax measures, but focus on the equal treatment of cross-border and domestic situations.

Unlike in the area of indirect taxes, direct taxes have not experienced a high degree of positive integration within the EU. Fiscal sovereignty is an essential element of the enforcement of State

powers and can be defined as the autonomous competence to introduce and enforce a tax system. Although direct tax law is not a harmonised area within EU law, the sovereignty of Member States is not absolute: The Court has ruled in many cases that fiscal sovereignty does not justify national tax rules that lead to discrimination or unjustified restriction of activities covered by the fundamental freedoms. Therefore, the main focus will be on the case law of the CJEU, which distinguishes between general tax measures (which fall under tax sovereignty) and selective tax incentives (which give rise to proceedings). However, it will be shown that the concepts of generality and selectivity are not necessarily mutually exclusive. To summarise, the most serious restrictions on Member States' fiscal sovereignty are, on the one hand, the fundamental freedoms enshrined in the free movement provisions of the TFEU and, on the other hand, the State aid rules laid down in Articles 107 and 108 TFEU.

The terms 'discrimination' and 'equal treatment' are at the centre of the investigations carried out. On the one hand, the fundamental freedoms, in particular the case law surrounding them, include a non-discrimination standard when assessing measures in the area of direct taxation. A static methodology can be recognised. On the other hand, the analysis of State aid under Article 107(1) TFEU is not explicitly based on such a standard. In recent years, however, the CJEU has increasingly transformed the selectivity analysis into an equal treatment test. This approach is not very coherent, as there are no fixed standards of comparison. In practice, the benchmarks chosen and applied by the European courts and the Commission often differ from those of the national tax authorities. Thus, the practical importance of a consistent and coherent methodology with a non-discrimination test modelled on the fundamental freedoms test for the assessment of State aid for tax purposes is demonstrated. From a dynamic perspective, there is a tendency towards convergence in the methods of analysis used to assess tax measures, which will be illustrated in this thesis. The focus is therefore on the development and derivation of common theoretical and methodological aspects. Such convergence does not mean or imply a complete analogy. Rather, it makes it possible to transfer lessons from one method to the other that can contribute to solving conceptual problems arising from the application of State aid rules to direct tax measures. The trend towards convergence has been most evident in the case law of the CJEU, particularly in its interpretation of Article 107(1) TFEU. Therefore, an in-depth analysis of the case law is necessary in order to develop a more systematic approach to the application of State aid rules.

The study aims to assess the hypothesis that there is an actual trend towards convergence between the concepts of selectivity and non-discrimination in tax aid and that the selectivity criterion of Article 107 TFEU includes a non-discrimination standard for tax aid as found in the fundamental freedoms. The aim is to analyse whether and where such a standard is uniform. The focus of the work is therefore on the material aspect of the selectivity criterion and its methodological reorganisation.

The first chapter after the introduction (formally the second chapter) explains the normative framework, i.e. the State aid rules and the fundamental freedoms analysed, as well as their relationship to each other. The regulatory and legislative developments at international level that accelerate or influence the European approach are also analysed here. The third chapter focuses on the selectivity criterion of Article 107 TFEU and its application by the Commission and the Court. The fourth chapter deals with the fundamental freedoms and the application of the non-discrimination test to tax measures. These two chapters contain a detailed analysis of the case law of the CJEU in order to identify methodological shortcomings. The fifth chapter deals with the development of convergence between State aid law and the fundamental freedoms. It analyses whether the non-discrimination test applied in the context of the fundamental freedoms is also necessary for Article 107 TFEU or whether the test should be identical. The conclusion is essentially that an adaptation is needed that combines the best of both. Such an adapted test is then proposed on the basis of the case law analysis.

German Abstract

Staatliche Beihilfen gibt es in vielen verschiedenen Formen und Ausprägungen. Die EU-Mitgliedstaaten erwägen zunehmend unauffällige und indirekte Wege, um Unternehmen in Form von Steueranreizen und -vergünstigungen anzuziehen und zu finanzieren, und so den Steuerwettbewerb zu verstärken. Angesichts des heutigen Trends zur Digitalisierung und Globalisierung führt dies dazu, dass Unternehmen international tätig werden und Geschäftsmöglichkeiten ausloten. Die von der EU, vor allem der EU-Kommission, angestrebte verschärfte Beihilfenkontrolle zielt nicht nur auf die nationalen direkten Steuergesetze, sondern auch auf Einzelmaßnahmen ab. Ein zentrales Problem der sich immer weiter ausbreitenden Beihilfekontrolle steuerlicher Maßnahmen besteht darin, dass nicht vornherein vorhersehbar ist, ob eine Maßnahme als mit dem Binnenmarkt unvereinbar eingestuft wird. Dies führt zu Rechtsunsicherheit für nationale Gesetzgeber und betroffene Unternehmen. Gleichzeitig kann diese Unsicherheit die Steuerautonomie der Staaten ernsthaft untergraben. Um einen Zuständigkeitskonflikt zu lösen und mehr Rechtssicherheit zu schaffen muss die Beihilfenkontrolle stärker auf den eigentlichen Zweck der Beihilfevorschriften ausgerichtet werden. Dies beinhaltet die Vermeidung von grenzüberschreitenden Handelsverzerrungen und der damit verbundenen Ungleichbehandlung. Eine solche Umstrukturierung läge im Interesse einer einheitlichen Entwicklung des EU-Rechts.

Eines der Hauptziele der EU ist die Verwirklichung des gemeinsamen Binnenmarktes mit dem freien Verkehr von Kapital, Arbeit, Technologie und Unternehmen zwischen den Mitgliedstaaten. Die Vorschriften über staatliche Beihilfen zielen auch darauf ab, den Binnenmarkt zu stärken, indem Markt- und Wettbewerbsverzerrungen, die durch staatliche Eingriffe entstehen, bekämpft werden. Die Frage der Selektivität steht im Mittelpunkt der Analyse der steuerlichen Beihilfen, da die anderen Voraussetzungen des Artikel 107(1) AEUV in der Regel erfüllt sind oder als erfüllt gelten und daher nicht näher untersucht werden müssen. Darüber hinaus prüfen die Kommission und der EuGH Beihilfemaßnahmen nicht nach ihrer Form, sondern nach ihren Auswirkungen. In dieser Hinsicht hat die Kommission als Hüterin der Verträge schrittweise eine Reihe von Soft-Law-Instrumenten eingeführt und hält daran fest, um ihren Ansatz im Rahmen des Beihilferechts weiter zu strukturieren.

Nicht nur die Vorschriften über staatliche Beihilfen, sondern auch die Bestimmungen des Vertrags über die Grundfreiheiten verbieten die Gefährdung des freien Wettbewerbs im Binnenmarkt. Demselben Zweck dienend, wahren sie den unverfälschten Wettbewerb mit gleichen Ausgangsbedingungen für alle Wirtschaftsteilnehmer und stellen somit ein wirksames

Instrument zur Förderung der europäischen Steuerintegration dar. Die Grundfreiheiten beruhen alle auf dem Grundsatz der Nichtdiskriminierung. Sie unterscheiden nicht zwischen allgemeinen und spezifischen Steuermaßnahmen, sondern konzentrieren sich auf die Gleichbehandlung von grenzüberschreitenden und inländischen Sachverhalten.

Anders als im Bereich der indirekten Steuern haben die direkten Steuern kein hohes Maß an positiver Integration innerhalb der EU erfahren. Die Steuerhoheit ist ein wesentliches Element der Durchsetzung staatlicher Befugnisse und kann als autonome Kompetenz zur Einführung und Durchsetzung eines Steuersystems definiert werden. Obwohl das direkte Steuerrecht kein harmonisierter Bereich innerhalb des EU-Rechts ist, ist die Souveränität der Mitgliedstaaten nicht absolut: Der EuGH hat in vielen Fällen entschieden, dass die Steuerhoheit keine nationalen Steuervorschriften rechtfertigt, die zu einer Diskriminierung oder ungerechtfertigten Einschränkung von Tätigkeiten führen, welche unter die Grundfreiheiten fallen. Daher wird der Schwerpunkt vor allem auf der Rechtsprechung des EuGH liegen, die zwischen allgemeinen steuerlichen Maßnahmen (die unter die Steuerhoheit fallen) und selektiven steuerlichen Anreizen (die Anlass zu Verfahren geben) unterscheidet. Es wird jedoch gezeigt werden, dass sich die Begriffe der Allgemeingültigkeit und der Selektivität nicht notwendigerweise gegenseitig ausschließen. Zusammenfassend lässt sich sagen, dass die schwerwiegendsten Einschränkungen der Steuerhoheit der Mitgliedstaaten zum einen die in den Freizügigkeitsbestimmungen des AEUV verankerten Grundfreiheiten und zum anderen die in den Artikeln 107 und 108 AEUV niedergelegten Vorschriften über staatliche Beihilfen sind.

Die Begriffe „Diskriminierung" und „Gleichbehandlung" stehen im Mittelpunkt der durchgeführten Untersuchungen. Einerseits beinhalten die Grundfreiheiten, insbesondere die sie umgebende Rechtsprechung, einen Nichtdiskriminierungsstandard bei der Beurteilung von Maßnahmen im Bereich der direkten Steuern. Es ist also eine statische Methodik zu erkennen. Andererseits ist die Analyse staatlicher Beihilfen gemäß Artikel 107(1) AEUV nicht ausdrücklich auf einen solchen Standard aufgebaut. In den letzten Jahren hat der EuGH die Selektivitätsanalyse jedoch zunehmend in eine Gleichbehandlungsprüfung umgewandelt. Dieses Vorgehen ist nicht sehr kohärent, da es keine festen Vergleichsmaßstäbe gibt. In der Praxis unterscheiden sich die von den europäischen Gerichten und der Kommission gewählten und angewandten Vergleichsmaßstäbe häufig von denen der nationalen Steuerbehörden. So wird die praktische Bedeutung einer konsistenten und kohärenten Methodik mit einem Nichtdiskriminierungstest nach dem Vorbild der Prüfung der Grundfreiheiten für die Bewertung steuerlicher staatlicher Beihilfen aufgezeigt. Aus einer dynamischen Perspektive lässt sich eine

Tendenz zur Konvergenz der Analysemethoden, mit denen steuerliche Maßnahmen geprüft werden, erkennen, die in dieser Untersuchung dargestellt werden soll. Der Schwerpunkt liegt also auf der Entwicklung und Ableitung gemeinsamer theoretischer und methodischer Aspekte. Eine solche Konvergenz bedeutet oder impliziert nicht eine vollständige Analogie. Vielmehr ermöglicht sie es, Lehren aus einer Methode auf die andere zu übertragen, die zur Lösung konzeptioneller Probleme beitragen können, welche sich aus der Anwendung der Beihilfevorschriften auf Maßnahmen im Bereich der direkten Steuern ergeben. Die Tendenz zur Konvergenz wurde am deutlichsten in der Rechtsprechung des EuGH sichtbar, dies vor allem in seiner Auslegung des Artikels 107(1) AEUV. Daher ist eine eingehende Analyse der Rechtsprechung erforderlich, um einen systematischeren Ansatz für die Anwendung der Vorschriften über staatliche Beihilfen zu entwickeln.

Die Untersuchung soll die Hypothese bewerten, dass es einen tatsächlichen Trend zur Konvergenz zwischen den Konzepten der Selektivität und der Nichtdiskriminierung bei Steuerbeihilfen gibt und dass das Selektivitätskriterium des Artikels 107 AEUV eine Nichtdiskriminierungsnorm für Steuerbeihilfen beinhaltet, wie sie auch in den Grundfreiheiten zu finden ist. Es soll untersucht werden, ob und wo ein solcher Standard einheitlich ist. Der Schwerpunkt der Arbeit liegt daher auf dem materiellen Aspekt des Selektivitätskriteriums und seiner methodischen Neuordnung.

Das erste Kapitel nach der Einleitung (formell also das zweite Kapitel) erläutert den normativen Rahmen, d.h. die Beihilfevorschriften und die untersuchten Grundfreiheiten sowie deren Verhältnis zueinander. Auch die regulatorischen und legislativen Entwicklungen auf internationaler Ebene, die den europäischen Ansatz beschleunigen oder beeinflussen, werden hier untersucht. Das dritte Kapitel konzentriert sich auf das Selektivitätskriterium des Artikel 107 AEUV und seine Anwendung durch die Kommission und den EuGH. Das vierte Kapitel befasst sich mit den Grundfreiheiten und der Anwendung des Nichtdiskriminierungstests auf steuerliche Maßnahmen. Diese beiden Kapitel enthalten eine ausführliche Analyse der Rechtsprechung des EuGH, um methodische Mängel aufzuzeigen. Das fünfte Kapitel befasst sich mit der Entwicklung der Konvergenz zwischen dem Beihilferecht und den Grundfreiheiten. Es wird untersucht, ob der im Rahmen der Grundfreiheiten angewandte Nichtdiskriminierungstest auch für Artikel 107 AEUV erforderlich ist bzw. ob der Test identisch sein sollte. Die Schlussfolgerung lautet im Wesentlichen, dass eine Anpassung erforderlich ist, die das Beste aus beiden vereint. Auf der Grundlage der Rechtsprechungsanalyse wird dann ein solcher angepasster Test vorgeschlagen.

List of Abbreviations

AG	Advocate General (ECJ)
ALP	Arm's Length Principle
APA(s)	Advance pricing agreement(s)
Art(s)	Article(s)
ATAD	Anti-Tax Avoidance Directive
ATT	Air Travel Tax (Ireland)
BEFIT	Business in Europe: Framework for Income Taxation
BEPS	Base erosion and profit shifting
CCTB	Common Corporate Tax Base
CCCTB	Common Consolidated Corporate Tax Base
CFR	EU Charter of Fundamental Rights
CJEU	Court of Justice of the European Union (GC and ECJ as unity/institution, also referred to as 'the Court')
CPLM	Cost Plus Method
CUP	Comparable Uncontrolled Method
DTC(s)	Double tax convention(s)
ECJ	European Court of Justice
ECOFIN	Economic and Financial Affairs Council
EIG	Economic Interest Grouping
EU	European Union
EUR	Euro
G20	Group of Twenty (19 countries plus the European Union)
GC	General Court
GILTI	Global Intangible Low Tax Income (US)
GDP	Gross domestic product
HUF	Hungarian Forint
IP	Intellectual property
IPT	Insurance Premium Tax
MNE(s)	Multinational enterprise(s)
MS	Member State(s) of the European Union

MTC	Model Tax Convention (OECD)
NO_x	Nitrogen oxides
OECD	Organisation for Economic Co-operation and Development
PSM	Profit Split Method
RPM	Resale Price Method
SCS	*société en commandite simple* (Luxembourg, limited partnership)
STL	Spanish Tax Lease
TEU	Treaty on the European Union
TFEU	Treaty on the Functioning of the European Union
TNMM	Transactional Net Margin Method
UK	United Kingdom
US	United States of America
VAT	Value added tax

1. Introduction

State aid manifests in various forms, often disguised, with Member States (MS) increasingly resorting to subtle methods of tax incentives to support and attract businesses. Adam Smith's early work suggested that, in an ideal economy, State influence on the economic behaviour of market players should be minimised.[1] However, when it comes to taxation, which is a fundamental prerequisite for the functioning of any economy, State involvement is inevitable. State aid and direct taxation intersect at the core of European Union (EU) law and MS sovereignty, reflecting the complex balance between national fiscal policies and the EU's goal of maintaining fair competition. While direct taxation is traditionally seen a MS competence, direct tax measures are not exempt or immune from the prohibition of State aid. This is because selective tax advantages granted to certain undertakings can distort competition and affect cross-border trade within the internal market. Scandals such as LuxLeaks, where whistleblowers revealed preferential tax arrangements and deals granted by the national tax authority to multinational companies, have spotlighted the phenomenon of selective fiscal measures even more. As a result, the European Commission and the Court of Justice of the European Union (CJEU, the Court) have increasingly applied State aid rules to direct tax measures, bringing this area into sharper focus and raising important questions about legal certainty, fiscal sovereignty and market fairness.

A central problem of the ever-widening oversight of fiscal measures is the unpredictability surrounding whether a tax policy or measure will be deemed incompatible with State aid rules, creating substantial legal uncertainty for both national legislators and undertakings. This uncertainty, in turn, severely undermines the fiscal autonomy of MS, who, in principle, are free to design their tax systems and to adopt tax measures as they see fit, provided they comply with EU law. To address this jurisdictional tension and foster greater legal certainty, State aid control must be realigned with its core objectives: preventing distortions in cross-border trade and ensuring equal treatment. A more structured and purpose-driven approach would contribute to the uniform development of EU law and better balance the fiscal sovereignty of MS with the EU's competition goals.

The selectivity test applied under Article (Art) 107(1) of the Treaty on the Functioning of the European Union (TFEU) plays a critical role in determining whether a national measure confers a selective advantage to certain undertakings, thereby distorting competition within the internal

[1] Adam Smith, *The Wealth of Nations* (W Strahan and T Cadell 1776) Book I, ch VIII, 84, para 13 and Book II, ch III, 343-346, paras 31 and 36.

market. Interestingly, the selectivity test shares conceptual similarities with the non-discrimination analysis used in the context of the EU's fundamental freedoms. Both frameworks rely on comparability assessments to determine whether unequal treatment exists. The more structured and refined approach of the fundamental freedoms provides valuable insights for improving the selectivity test, especially in terms of clearer criteria and more consistent methodology. Learning from the approach under the fundamental freedoms could help enhance the selectivity test's effectiveness, fostering greater legal certainty and uniformity in its application across the EU.

1.1. Background and Problem Overview

Direct tax measures, including tax rulings, the global issue of base erosion and profit shifting (BEPS) and EU State aid law represent a complex intersection of national sovereignty, international tax policy and competition rules. Tax measures and tax rulings are increasingly being scrutinised for granting selective advantages that may conflict with EU State aid rules. Meanwhile, BEPS, an international phenomenon in which multinational enterprises (MNEs) shift profits to low- or no-tax jurisdictions to reduce their tax liabilities, has triggered global reform efforts led by the Organisation for Economic Co-operation and Development (OECD) to curtail such practices. Within the EU, this landscape is further complicated by State aid law, in particular Art 107(1) TFEU, which is enforced by the Commission, by subjecting national tax measures that distort competition to close scrutiny. This has created a legal tension between the desire of MS to use tax policy as an instrument for economic competition and the EU's aim of ensuring a level playing field. As a result, businesses and governments face uncertainty and increased scrutiny when navigating the overlapping demands of national tax systems, international initiatives and EU law.

1.1.1. Tax Competition and the Digital Economy

Digitalisation and globalisation are rapidly changing today's reality: our world of business consists of MNEs expanding across borders to explore and seize global commercial opportunities. A growing concern is the ability of these companies to establish a significant digital presence in foreign economies without being liable to taxation, leveraging strategies that further complicate tax enforcement. Capital flows freely and uncontrollably across borders, with considerable efforts devoted to the reduction or avoidance of tax.[2] This makes the task of accurately allocating profits particularly challenging. Tax competition, where jurisdictions offer

[2] Fausta Todhe, 'The Rise of an (Autonomous) Arm's Length Principle in EU State Aid Rules?' (2019) EStAL 249, 256.

tax incentives and concessions to attract the settlement of businesses, intensifies this issue. Such competition may emerge between entire tax systems or can be based on special arrangements for particular practices, such as tax rulings.[3] Without nations providing preferential tax regimes, international BEPS strategies by MNEs would lose much of their impact. A prominent example of such tax competition is the LuxLeaks scandal. The International Consortium of Investigative Journalists revealed how Luxembourg's tax authorities issued numerous advance tax rulings between 2002 and 2010, resulting in a drastic reduction of the corporate income tax for over 300 MNEs, including major companies like IKEA, Pepsi and Vodafone. Many of these Luxembourg subsidiaries managed vast sums of money while maintaining little or no presence and conducting little or no economic activity there.[4] Such incidents fuel growing anti-MNE sentiment across Europe and, while LuxLeaks did not reveal anything new to the awareness that such tax practices occur worldwide, it likely accelerated the Commission's State aid investigations.

The digital economy encompasses all businesses depending and relying on improvements and developments in information and communication technology. Nearly every sector of the economy has already been impacted by the rapid growth of this industry, which is increasingly becoming integral to the economy itself, rather than a separate entity.[5] Despite the widespread influence of digitalisation, the current tax framework remains designed for the traditional economy and is unable to fully capture activities based on intangible assets and data. Businesses today depend increasingly on intellectual property (IP), which can be easily relocated, as well as on data and on automation, enabling large-scale cross-border operations without a physical presence.[6] National and international tax systems have not kept pace with these developments. Consequently, MNEs are aggressively organising and structuring their business and operations to exploit the disconnect between their business models and outdated global tax rules. It has become clear that the Commission is no longer willing to tolerate these distortions of competition, particularly those subsidised by States. The Commission is increasingly using its

[3] Valère Moutarlier, 'Reforming the Code of Conduct for Business Taxation in the New Tax Competition Environment' in Isabelle Richelle, Wolfgang Schön and Edoardo Traversa (eds), *State Aid Law and Business Taxation* (Springer 2016) 76.
[4] European Parliament, 'Special Report on tax rulings and other measures similar in nature or effect (2015/2066(INI))' (5 November 2015) <https://www.europarl.europa.eu/doceo/document/A-8-2015-0317_EN.html?redirect> accessed 15 September 2024, 6; Leslie Wayne and others, 'Leaked Documents Expose Global Companies' Secret Tax Deals in Luxembourg' (ICIJ, 5 November 2014) <https://www.icij.org/investigations/luxembourg-leaks/> accessed 15 September 2024.
[5] Joachim Englisch, 'BEPS Action 1: Digital Economy – EU Law Implications' (2015) British Tax Review 280, 282.
[6] Eric Kemmeren, 'Should the Taxation of the Digital Economy Really be Different?' (2018) 2 EC Tax Review 72, 73.

powers under Arts 107 and 108 TFEU to take action against large companies engaging in tax avoidance strategies.

1.1.2. State Aid, the 'Visible Hand'

One of the main objectives of the EU is market integration with the unhindered moving of capital, labour, technology and businesses across MS.[7] The State aid rules, embedded in the TFEU, aim to support this goal by promoting and ensuring undistorted competition within the internal market. These rules place controls on State interventions that provide economic and financial assistance and advantages to undertakings in a selective manner, ensuring that such measures do not distort the level playing field. In recent years, there has been growing recognition that national direct tax measures may involve State aid. This awareness stems from the fact that fiscal support, such as tax incentives, can be far harder to detect than straightforward cash subsidies.[8] Especially individual measures in the form of tax rulings are particularly suspected as potential sources of unlawful aid, as they may confer selective advantages to specific undertakings. In response, the Commission has intensified its efforts to combat fiscal State aid.

While direct taxation falls principally within the competence of the MS, it must be exercised in alignment with EU law, particularly the rules on State aid and fundamental freedoms. Both sets of rules serve the same purpose of preserving a competitive internal market, free from discrimination and distortion.[9] The most significant constraints imposed on MS' fiscal sovereignty arise from the free movement provisions of the TFEU and the State aid rules under Arts 107 and 108 TFEU.[10] Both frameworks embody the principle of non-discrimination, supporting the free movement of goods, services, capital and people, while ensuring that competition remains fair and undistorted. However, tensions and overlaps between these rules often arise.[11] While the Commission cannot approve aid measures that infringe on other EU laws, such as free movement rights, contradictions sometimes emerge in how these provisions are applied.

[7] Ali El-Agraa, *The European Union: Economics and Policies* (9th edn, CUP 2011) 1.
[8] See Case C-387/92 *Banco Exterior* [1994] ECR I-877, para 13, in which the ECJ clearly stated that the concept of fiscal aid is wider than that of subsidies.
[9] Rita Szudoczky, *The sources of EU law and their relationships: Lessons for the field of taxation* (IBFD Doctoral Series 2013) 469.
[10] Pasquale Pistone, 'Smart Tax Competition and the Geographical Boundaries of Taxing Jurisdictions: Countering Selective Advantages Amidst Disparities' (2012) 40 Intertax 85, 85-89.
[11] See *inter alia* Case C-169/08 *Presidente del Consiglio dei Ministri* [2009] ECR I-10821; Case C-451/03 *Servizi Ausiliari Dottori Commercialisti* [2006] ECR I-2941; Case C-156/98 *Germany v Commission* [2000] ECR I-6857; Case C-18/84 *Commission v France* [1985] ECR 1339.

The key difference between State aid law and fundamental freedoms lies in the nature of the distinctions they address. State aid focuses on internal, intra-State distinctions, where positive discrimination occurs by favouring certain undertakings or sectors within a single country. In contrast, the free movement rules address inter-State distinctions, targeting negative discrimination that disadvantages cross-border activities compared to domestic ones.[12] For example, free movement provisions focus on ensuring that non-residents or foreign income are not treated less favourably than domestic counterparts. Ultimately, however, both frameworks converge on two core principles: the comparability or discrimination analysis and the justification test. These elements form the basis for assessing whether certain measures infringe upon EU law, whether through selective tax measures in the context of State aid or discriminatory practices restricting free movement. To ensure a fully integrated and competitive market, it is crucial to navigate these complexities and harmonise the application of both.

1.1.3. The Sensitivity of Selectivity

In the realm of direct tax law, the critical issues often centre around the concepts of selectivity, advantage and anticompetitive effects. Among these, the selectivity issue lies at the heart of tax aid cases because the other conditions laid down in Art 107(1) TFEU are usually satisfied. The notion of selectivity, which determines whether a measure benefits certain undertakings over others, consists of two components, geographic and material selectivity. Whilst the concept of territorial or geographic selectivity has largely been clarified by the CJEU, material selectivity remains an area of ambiguity.

Under the current legal standard, the assessment of material selectivity includes both the derogation and comparability approach. A tax measure is deemed selective if it derogates from a reference system, leading to the differential treatment of companies that are in objectively comparable legal and factual situations. Once a tax measure departs from the ‘normal’ system and benefits certain undertakings, it is presumed to be discriminatory or selective unless the measure can be justified by the nature or general scheme of the tax system. The core test in this evaluation is the comparability analysis, which is closely linked to the concept of equal treatment and non-discrimination.[13]

However, the methodological analysis of State aids boasts discrepancies in the Commission’s practice and the CJEU’s case law. In recent years, the Court has progressively endorsed an

[12] Peter Wattel, ‘Forum: Interaction of State Aid, Free Movement, Policy Competition and Abuse Control in Direct Tax Matters’ (2013) World Tax Journal 128, 129.
[13] José Luis Buendía, ‘Finding Selectivity or the Art of Comparison’ (2018) EStAL 85, 88.

increasingly extensive interpretation of the selectivity requirement, making it easier for the Commission to demonstrate its fulfilment. This expansive interpretation reflects the Commission's growing use of State aid control as a tool to tackle the most severe forms of tax-based competition that could distort the internal market.[14] Prominent examples of this phenomenon are the *Fiat*[15] and *Starbucks*[16] cases, recently decided by the CJEU, which both involve tax rulings issued by national authorities. Tax rulings, in themselves, are not problematic. They are comfort letters from tax authorities that offer businesses legal certainty regarding how their tax liabilities will be calculated.[17] Nevertheless, these rulings can fall under the scope of EU State aid law if they provide a selective advantage to specific companies. Moreover, these cases highlight the issue of 'selective advantage'. The blending and conflation of the selectivity and economic advantage tests has led to methodological difficulties, particularly when assessing transfer pricing practices, undermining the clarity of legal reasoning.[18] These cases demonstrate how the Commission is willing to critically analyse transfer pricing methods used. This approach has attracted criticism for overstepping the Commission's mandate and interfering with the MS's sovereignty, raising concerns about legal uncertainty.[19] As the legal landscape continues to evolve, the debate over how best to balance these competing interests is likely to intensify.

As this thesis shows, the selectivity test, composed of the three-step test, poses several methodological challenges that complicate its consistent application. One of the core problems is to define the appropriate reference system, which a tax measure derogates from in a first step. It is not always possible to determine what constitutes the 'normal' or 'general' tax system, especially in complex tax systems with multiple layers of rules and exceptions. This ambiguity creates significant room for interpretation, allowing national authorities, the Commission and the CJEU to construct differing reference systems, leading to inconsistent outcomes in different cases. Moreover, the lack of a standardised approach to assessing comparability in a second step further exacerbates these inconsistencies. In theory, the comparability analysis should focus on determining whether similar undertakings are treated differently under the same tax

[14] Lorenzo Panci, 'Latest Developments on the Interpretation of the Concept of Selectivity in the Field of Corporate Taxation' (2018) EStAL 353, 353.
[15] Joined Cases T-755/15 and T-759/15 *Luxembourg v Commission* [2019] ECLI:EU:T:2019:670; Joined Cases C-885/19 P and C-898/19 P *Fiat Chrysler Finance Europe v Commission* [2022] ECLI:EU:C:2022:859.
[16] Joined Cases T-760/15 and T-636/16 *Netherlands v Commission* [2019] ECLI:EU:T:2019:669.
[17] Carlo Romano, *Advance Tax Rulings and Principles of Law: Towards a European Tax Rulings System?* (IBFD 2002) 485.
[18] Lorenzo Panci, 'Latest Developments on the Interpretation of the Concept of Selectivity in the Field of Corporate Taxation' (2018) EStAL 353, 364.
[19] Fausta Todhe, 'The Rise of an (Autonomous) Arm's Length Principle in EU State Aid Rules?' (2019) EStAL 249, 250.

system. However, the criteria for determining comparability vary from case to case. Finally, the third step, in which a selective measure may be justified by the nature or logic of the tax system, adds an additional layer of complexity. The scope of acceptable justifications remains vague, leading to uncertainty about which measures can legitimately be defended under the general scheme of the tax system. This uncertainty, coupled with the broad discretion afforded to the Commission in assessing justifications, creates an unpredictable legal environment for MS and businesses. Overall, the methodological problems associated with the selectivity show that more clarity and consistency in the application of State aid rules to tax measures is needed. Without such reforms, legal uncertainty will persist and the effectiveness of State aid control, as well as the tax sovereignty of MS, will be undermined.

1.1.4. The (Almost) Perfect Example of the Fundamental Freedoms

The non-discrimination approach in the context of fundamental freedoms is designed to prevent unequal treatment of cross-border economic activities compared to purely domestic ones. Under this approach, MS are prohibited from adopting tax rules that disadvantage individuals or businesses from other MS. At the heart of the assessment is the comparability test, which compares the legal and factual situation of domestic and foreign taxpayers to determine whether the tax treatment is discriminatory. If such discrimination exists, the measure must be justified by an overriding public interest and meet the proportionality requirement.

Unfortunately, this approach also raises several methodological issues. Case law has not always provided clear guidance on when taxpayers should be considered objectively comparable, leading to inconsistent outcomes depending on the type of fundamental freedom at stake (e.g. free movement of workers versus freedom of establishment). A fully consistent approach is also missing from the justification and proportionality analyses. MS often rely on justifications related to maintaining the coherence of the national tax system or preventing tax avoidance, but the scope of these justifications is not always clear and their application has been inconsistent. The Court has been criticised for being too strict in rejecting certain justifications, while accepting others in similar circumstances, leading to unpredictable rulings. Finally, the non-discrimination approach tends to focus on the negative impact of a tax measure on cross-border activities, sometimes overlooking the broader context of national tax policy. This narrow focus may limit the ability of MS to pursue legitimate tax policies tailored to their domestic needs, as they risk violating fundamental freedoms. The challenge is to reconcile the protection of the internal market's integrity with respect for national tax sovereignty, a difficult balance to effectively resolve with the current methodology.

1.1.5. Convergence and Divergence

When comparing the requirements for the existence of State aid with those for an impediment to a fundamental freedom, a tendency towards convergence becomes apparent. The most relevant assessment criteria seem to be (i) a comparability or discrimination analysis and (ii) a justification inquiry. The convergence between the State aid and the fundamental freedom examinations occurs primarily during the comparability analysis, where the legal and factual circumstances are examined in light of the purpose of the relevant tax measure. In free movement cases, the analysis focuses on whether cross-border situations are disadvantaged compared to domestic ones, making investments, work or trade more difficult. In State aid cases, the analysis looks for unjustified benefits, examining whether certain undertakings receive preferential treatment that distorts competition.[20] However, State aid rules have a broader scope than fundamental freedoms. While the latter focusses on cross-border issues, State aid can address purely domestic tax measures with no foreign businesses being involved. Therefore, a tax measure may constitute State aid without infringing fundamental freedoms. Further parallels are found in the second stage of the assessment, the justification inquiry. In the context of fundamental freedoms, the rule of reason balances the extensive interpretation of free movement by allowing justifications for restrictions. Similarly, in State aid cases, the effect-based doctrine of the nature and general scheme of the system provides a balance between maintaining undistorted competition and respecting the fiscal sovereignty of MS.[21] The justification grounds available for both resemble each other, as they are all reasons internal to the tax system, and both require that the measures meet the requirements of proportionality.[22]

Despite the overlap, the convergence between the two is limited to cross-border situations.[23] Moreover, certain tax measures may simultaneously violate both State aid rules and fundamental freedoms, a situation known as double qualification.[24] The Court, however, has yet to address the specific consequences of this dual infringement. These differences are, however, of secondary importance. The real problem lies in the shortcomings of both investigations. Both the selectivity test and the non-discrimination test have weaknesses. The deficiencies indicate that while the selectivity test in State aid law may well be inspired by the

[20] Peter Wattel, 'Forum: Interaction of State Aid, Free Movement, Policy Competition and Abuse Control in Direct Tax Matters' (2013) World Tax Journal 128, 130.
[21] Begona Pérez-Bernabeu, 'Refining the Derogation Test on Material Tax Selectivity: The Equality Test' (2017) EStAL 582, 586.
[22] José Luis Buendía Sierra, 'Finding Selectivity or the Art of Comparison' (2018) EStAL 85, 91.
[23] Svitlana Buriak and Ivan Lazarov, 'Between State Aid and the Fundamental Freedoms: The Arm's Length Principle and EU Law' (2019) 56 CMLR 905, 907.
[24] See eg Case C-169/08 *Presidente del Consiglio dei Ministri* [2009] ECR I-10821.

fundamental freedoms, the non-discrimination test cannot simply be copied or adopted. Rather, an alternative solution is needed, even in the form of a new type of test.

1.2. Research Objectives

The aim of the thesis is to prove the hypothesis that the selectivity assessment under State aid law and the non-discrimination test under fundamental freedoms converge. There is an interaction and overlap between these two essential concepts of the internal market in the context of direct taxation. The establishment of such a convergence can be useful for several reasons. Both frameworks are based on the principles of equality and fairness. The selectivity test in State aid law examines whether a measure gives certain undertakings an unjustified advantage, while the non-discrimination test seeks to ensure equal treatment of comparable situations. Fundamentally, both legal frameworks aim to ensure a level playing field within the internal market, free from unequal treatment or distortion of competition. The rules on State aid and fundamental freedoms often overlap, particularly in areas such as direct taxation. Direct tax measures may fall within the scope of both sets of rules, raising the question of whether the analyses performed under each regime are sufficiently similar and whether insights from one can inform the other. Convergence can lead to greater consistency in the application of these principles and to a more holistic understanding of the underlying legal frameworks. This includes developing consistency for certain similar concepts applied to both areas, such as comparability and justification. Officially recognising the selectivity test as a subset of non-discrimination would also eliminate the ambiguity that the selectivity test already uses the language of non-discrimination and is geared towards it. Furthermore, the Commission's overenforcement of the State aid rules in the area of direct taxation could be curbed by the creation of clear guidelines, in this case a new test based on the non-discrimination test, which would give MS the leeway to justify their tax policies. Aligning approaches can reduce ambiguity, promote consistent judicial and legal reasoning and provide clearer guidance to MS. Harmonisation and a unified approach increase legal certainty for MS, businesses and taxpayers and can help prevent conflicting interpretations and reduce litigation. Understanding and harmonising these assessments could optimise legal analysis and enforcement. Efficiency and simplification are especially valuable given the complexity of EU law and the need to balance national autonomy with the integrity of the internal market. Therefore, by examining the convergence between these two assessments, legal scholars and practitioners can contribute to a more integrated and efficient legal framework that better serves the EU's goals of market integration and fair competition.

To this end, the research will focus on the selectivity test under State aid law, investigating its flaws and inconsistencies through a detailed analysis of case law. The next step is to examine the approach taken under the fundamental freedoms, particularly the non-discrimination test, to assess whether the more established methodology used in these cases could be applied to State aid law. While the starting points of the methods of analysis appear distinct, the analysis aims to demonstrate that the concept of selectivity in State aid law is interpreted similarly to the concept of non-discrimination under the fundamental freedoms by the Commission and the CJEU. Hence, the research is driven by two core objectives: On the one hand, to identify and expose contradictions and inconsistencies in the case law surrounding State aid and fundamental freedoms (addressed in Chapters 3 and 4), On the other hand, to explore the potential for a unified methodological framework that bridges the two areas, aiming to remove these tensions (discussed in Chapter 5).

This research is based on the hypothesis that there is indeed a trend of convergence between the concepts of selectivity and non-discrimination in fiscal State aid. Accordingly, the overarching objective is to determine whether and where this convergence exists, particularly in the application of direct tax measures to safeguard the principle of equal treatment. By focusing on common theoretical and methodological elements, the research will evaluate whether the selectivity criterion inherently implies a non-discrimination standard similar to that under the fundamental freedoms. Finally, the thesis aims to assess whether the selectivity test under Art 107(1) TFEU requires restructuring to provide more legal certainty.

The central research question guiding this thesis is: *To what extent is there a convergence between the concepts of selectivity and non-discrimination in fiscal State aid?*

To answer this question, certain sub-questions arise that can be categorised by chapter.

- Chapter 2: Why is there a need to regulate fiscal State aid? What is the normative framework for direct tax measures within the EU? Is EU policy in this regard consistent with the limits imposed by the principle of national tax sovereignty?
- Chapter 3: What is the current methodological approach of the Commission and the CJEU when assessing the selectivity of tax aid under Art 107(1) TFEU? What is the problem with the selectivity test and why? Does the prohibition of State aid include a prohibition of discrimination and an obligation of equal treatment? If so, how is this expressed?

- Chapter 4: How are direct tax measures assessed in the context of the fundamental freedoms? Does this represent a more coherent and better approach?
- Chapter 5: Is the requirement of equal treatment under Art 107(1) TFEU comparable or identical to the non-discrimination test under the fundamental freedoms? Is it desirable to adopt the non-discrimination test for the selectivity test under Art 107(1) TFEU? How can the test best be adapted or is a new standard needed?

1.3. Relevance of the Research

The convergence of criteria between State aid rules and fundamental freedoms does not imply complete alignment. Instead, identifying convergence allows lessons to be drawn from one method of analysis to improve the other. This is particularly relevant for addressing conceptual challenges arising from the application of State aid rules to tax measures. Both frameworks are grounded in the principle of non-discrimination, which ensures free competition in the internal market remains undistorted.[25] EU fiscal State aid control, much like the fundamental freedoms, serves as a mechanism to promote tax policy convergence among MS through the imposition of common standards.

The application of State aid rules and the fundamental freedoms to direct tax measures is a complex matter and often leads to inconsistent outcomes due to the varying approaches taken by the CJEU. This inconsistency creates confusion and leaves many questions unresolved. Moreover, MS must become aware of their responsibility to legislate in line with EU treaties and provisions. The research aims to propose a comprehensive framework for applying State aid scrutiny to tax measures, building on the idea of methodological convergence with the fundamental freedoms. This would enhance legal certainty, benefiting not only MS but also taxpayers, the Commission and the CJEU.

The principle of equality or equal treatment is one of the fundamental principles of EU law and extends to all areas, including State aid. While incorporating an equality test into the State aid assessment may currently seem abstract, it holds practical significance. The latest Commission State Aid Scoreboard of 2023 revealed that MS spent EUR 227.98 billion on State aid in 2022, accounting for 1.4% of the gross domestic product (GDP).[26] This data underscores the relevance of State aid control. However, tax competition does not end at the frontiers of the EU.

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[25] Begona Pérez-Bernabeu, 'Refining the Derogation Test on Material Tax Selectivity: The Equality Test' (2017) EStAL 582, 594.

[26] Commission, 'State aid Scoreboard 2023' (9 April 2024) <https://competition-policy.ec.europa.eu/document/download/0b2037c5-c43f-4917-b654-f48f74444015_en> accessed 16 September 2024.

Eliminating all forms of tax incentives within the EU could drive investors to other attractive industrialised countries such as Switzerland, Japan or the United States (US), as well as global tax havens.

For this reason, the research highlights the importance of finding a balanced middle ground between the fiscal sovereignty of MS and the need to uphold fundamental EU standards within the State aid framework. Achieving such a balance would not only establish a clearer, more consistent approach to European tax law but also prevent the Commission from introducing new standards through the back door. A reformed methodology based on convergence would result in a fairer, simpler, better understandable and administrable tax system. In the long run, meaningful changes at the national level will likely occur only after international bodies like the OECD or the EU adopt and implement reforms.

1.4. State of the Research

Fiscal State aid is at the intersection of MS' sovereignty and the EU's goal of safeguarding an effective internal market. In recent years, the Commission and the CJEU have faced substantial criticism for the excessive broadening of the concept of selectivity in State aid cases. This criticism intensified after the Commission's and the Court's reasoning in the *Fiat*[27] and *Starbucks*[28] cases in September 2019. The main accusation concerns that the Commission's approach effectively leads to implicit harmonisation in the area of direct taxation, an area traditionally under national control.

Previous case law highlights the ambiguity and overly broad scope of the concept of selectivity in its practical application. This has resulted in a shift, particularly with the introduction of comparability requirements into the analysis under Art 107(1) TFEU. The need for reform to narrow and clarify the concept of selectivity is generally recognised, aiming for greater legal certainty and a more harmonised approach to State aid and tax policy across the EU. However, the proposed solutions, if any, vary significantly, with different arguments and perspectives contributing to an ongoing debate about how to reform the selectivity test (see Chapter 5.5.).

Despite the growing awareness of these issues, consistent and thorough research evaluating the practical operation of selectivity in the context of fiscal State aid remains scarce. This gap underscores the timeliness and importance of the present research, which seeks to contribute new ideas and insights to the existing body of knowledge. By specifically focusing on the

[27] Joined Cases T-755/15 and T-759/15 *Luxembourg v Commission* [2019] ECLI:EU:T:2019:670; Joined Cases C-885/19 P and C-898/19 P *Fiat Chrysler Finance Europe v Commission* [2022] ECLI:EU:C:2022:859.
[28] Joined Cases T-760/15 and T-636/16 *Netherlands v Commission* [2019] ECLI:EU:T:2019:669.

material aspect of selectivity in direct tax measures, this research addresses an under-researched area that has significant implications for the broader EU legal and fiscal landscape. This approach allows for a more detailed and in-depth analysis of selectivity in this specific context, contributing to the ongoing debate and suggesting avenues for reform.

1.5. Methodology

Over the years, the EU has evolved its original economic focus, gaining competences that affect various aspects of social, political and economic life. However, in areas such as direct taxation, the influence and significance of EU law remains relatively limited. This limitation, coupled with divergent interpretations by MS and inconsistencies in the reasoning of the CJEU, has fostered uncertainty in the application of EU law. The primary aim of this thesis is to address this uncertainty by developing a coherent conceptual framework. Relevant principles and standards from existing case law are identified, analysed and classified to construct a systematic and consistent methodology for the application of State aid rules to direct tax measures.

The research methodology draws on the interpretive tools traditionally used by the CJEU, which emphasise the *effet utile*, the practical effectiveness of the law. This involves examining the wording, context (including historical regulations) and objectives of the provisions to ensure that EU law is interpreted in a way that preserves coherence and practical impact. The treaties are understood as establishing a legal order that is consistent and complete.[29] Where ambiguity or gaps exist in EU law, the CJEU often engages in gap filling, ensuring that provisions align with the objectives of the Union. This process can also involve reducing the scope of provisions where excessive broadening was not necessarily foreseen by the legislator, which underscores the delicate and potentially political nature of the Court's interpretive role.[30]

A notable trend in the CJEU's case law is the convergence of the concepts of selectivity in State aid law and non-discrimination in the context of the fundamental freedoms. The CJEU has progressively interpreted the State aid prohibition in line with the non-discrimination standard, which is a cornerstone of the fundamental freedoms. This trend provides the basis for the research methodology, which systematically compares and analyses case law in both areas. The goal is to identify commonalities between the selectivity test and the non-discrimination test, exploring how insights from one area might improve the application of the other.

[29] Koen Lenaerts and José Antonio Gutiérrez-Fons, 'To Say What the Law of the EU is: Methods of Interpretation and the European Court of Justice' (2014) 20(2) Columbia Journal of European Law 3, 13-14.
[30] Koen Lenaerts and José Antonio Gutiérrez-Fons, 'To Say What the Law of the EU is: Methods of Interpretation and the European Court of Justice' (2014) 20(2) Columbia Journal of European Law 3, 25 and 28.

This research employs a combination of complementary methods. Much of the research is descriptive and normative, examining the current state of the fiscal State aid framework alongside the fundamental freedoms, and analysing how these frameworks function in practice. Throughout the chapters, the focus of analysis remains on the case law for both sets of rules. The primary method involves a detailed case law analysis, with a comparative legal approach that examines both State aid rules and fundamental freedom rules within EU law. The aim is to identify common principles, eliminate inconsistencies and propose a more harmonised approach to the treatment of fiscal State aid cases.

The approach followed is not a strictly black-letter approach, it is rather a reform-oriented and evaluative research. This allows for an assessment of the adequacy and quality of existing rules and case law, identifying areas where development and improvement are necessary. By focusing on commonalities between State aid law and the fundamental freedoms, the research seeks to highlight areas where the two sets of rules can convergence, particularly in the context of non-discrimination and selectivity.[31]

In its final stages, the research becomes prescriptive and conceptual, offering recommendations for a new framework to address the legal problems identified. The analysis draws on both the internal standard, the law, and the external standard, the policy aim.[32] On the one hand, the non-discrimination standard under the fundamental freedoms serves as the internal legal benchmark. On the other hand, the non-discrimination standard in the State aid analysis represents the external policy aim, which is ideally transformed from an external to an internal standard.

By proposing a restructured framework that integrates these concepts, the research aims to provide solutions to the current ambiguities in EU law, enhancing legal certainty for MS, taxpayers and EU institutions alike. The conclusion of the thesis offers concrete recommendations for aligning the selectivity test with the non-discrimination principle, contributing to the broader objective of harmonising European tax law and ensuring a fairer, more understandable legal system.

1.6. Outline of the Thesis

The research in this thesis is structured into four main parts, each comprising different chapters.

[31] Cf Mark Van Hoecke, 'Methodology of Comparative Legal Research' (2015) Law and Method 1; Rob van Gestel and Hans-Werner Micklitz, 'Revitalizing Doctrinal Legal Research in Europe: What About Methodology' (2011) EUI Working Paper LAW No 2011/05, 20ff.

[32] Sanne Taekema, 'Theoretical and Normative Frameworks for Legal Research: Putting Theory into Practice' (2018) Law and Method 1, 7ff.

The first part (Chapter 2) establishes the foundational understanding necessary for analysing the merger of the concepts of selectivity and non-discrimination in fiscal measures. To this end, it is indispensable to understand why tax measures are increasingly subject to scrutiny under State aid law. The chapter examines the competences of the MS in the area of direct taxation and how these competences have been constrained by the EU fundamental freedoms and State aid provisions. This includes tracing the developments affecting EU fiscal State aid control.

The second part examines the legal framework governing fiscal State aid. Chapter 3 provides an overview of the selectivity criterion under Art 107(1) TFEU, as applied in case law. The selectivity test is dismantled into its three constituent steps, the three-step test. Additionally, a specific subchapter is dedicated to the topic of tax rulings, which have become critical in recent fiscal State aid cases. This process is necessary and essential to identify areas for methodological improvement, which will be addressed later in comparison with the fundamental freedoms.

Chapter 4 shifts focus to the concept of non-discrimination and comparability within the framework of the fundamental freedoms. To this end, it provides a comprehensive analysis of case law relating to the free movement of workers, freedom of establishment, freedom to provide services and the free movement of capital. This thorough analysis aims to determine whether the more established non-discrimination standard offers a methodologically sound basis that could be integrated into State aid law.

The final part (Chapter 5) evaluates the findings from Chapters 3 and 4, focusing on the trend of convergence between the selectivity test in State aid law and the non-discrimination test under the fundamental freedoms. Through this comparative analysis, it becomes clear that the existing standards are inadequate and inconsistent. In response, this chapter also examines other areas of EU law, such as secondary law and competition law, to explore whether they can offer insights or even solutions to the problems identified. Finally, a new, modified test is proposed.

1.7. Limitations of the Research

This thesis focuses on the interaction between EU law and direct tax law, specifically examining fiscal State aid in the context of direct tax measures. Fiscal State aid may materialise in various forms, but the present research limits its scope to direct tax measures, excluding other forms of aid that fall under State aid provisions. Moreover, while transfer pricing is a relevant issue in fiscal State aid discussions, this research does not explore it in depth. The focus remains on the selectivity criterion and non-discrimination as interpreted in the judgements of both the GC and the ECJ, with Commission decisions mentioned only when necessary to understand the development of the methodology or where no court judgment has been rendered yet.

The thesis specifically addresses Art 107 TFEU and the fundamental freedoms of Arts 45, 49, 56 and 63 TFEU. In addition, only tax law measures are considered and assessed here. Accordingly, other provisions related to fiscal measures, such as Arts 30 and 110 TFEU, are not discussed further. The analysis is primarily concerned with the CJEU'S case law concerning these provisions, highlighting what the author deems to be the most significant and illustrative judgements. No specific focus is placed on which chamber of the CJEU ruled, though judgments from the Grand Chamber are frequently discussed due to their importance.

This thesis organises the analysis of direct tax measures into distinct categories, topics and, consequently, subchapters. These divisions aim to provide clarity, but they are not exhaustive. Moreover, the research is aware of the ongoing academic and judicial debates regarding the merging or separation of the selectivity criterion and the economic advantage test within State aid law. The author advocates for keeping these two criteria separate, but this thesis does not delve into this debate extensively. Instead, it concentrates on the modification or reform of the three-step test, i.e. focusing on selectivity and non-discrimination, rather than addressing the upgrading of the advantage test.

Finally, the research is limited by its temporal scope, as it includes material and case law published up until November 2024. Developments in legislation, case law or academic discourse beyond this date are not considered. Consequently, the findings and conclusions are based on the legal and academic landscape as it exists on this date.

2. The Normative Framework of Fiscal State Aid

The primary concern of EU competition law is to ensure a free market economy, where operators are prevented from acting anti-competitively in order to guarantee an optimally functioning market. The core of competition law is the restriction of agreements and concerted practices between undertakings such as cartels, the elimination of oligopolies and abuses of dominance, and merger control. Also State aid regulation is a central part to competition law rules, since it tries to fight the distortion of competition arising from State intervention granting beneficiary companies an advantage over competitors.[33] Art 3(1)(b) TFEU explicitly grants the EU the exclusive competence for establishing competition rules necessary for the functioning of the internal market, while Art 26(2) TFEU defines the internal market as "[…] an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured […]." Hence, State aid law serves as a regulatory instrument to achieve this goal.

Unlike the field of indirect taxation,[34] direct taxation has not experienced a great level of positive integration, i.e. harmonisation through the enactment of EU legislation. Instead, obstacles to the single market arising from differing tax systems and provisions have to be addressed in an alternative manner. Via negative integration, whereby the CJEU interprets EU law with a view to abolishing anti-competitive and discriminatory measures, a certain degree of approximation is sought. In the area of direct taxation, this process is based on the fundamental freedom provisions prohibiting their restriction (with some exceptions) and the State aid rules of Art 107 TFEU. Both regimes pursue the same objective: an internal market by ensuring a level playing field for all economic operators. The Court has long ago specified that the

> "[…] rules [on the free movement of goods] and the Treaty provisions relating to State aid have a common purpose, namely to ensure the free movement of goods between Member States under normal conditions of competition."[35]

This finding can also be applied to the other fundamental freedoms. The practical outcome of negative integration is the setting aside of incompatible national direct tax provisions and

[33] Claire Micheau, *State Aid, Subsidy and Tax Incentives Under EU and WTO Law* (Kluwer Law International 2014) 39; Alison Jones, Brenda Sufrin and Niamh Dunne, *Jones & Sufrin's EU Competition Law: Text, Cases, and Materials* (7th edn, OUP 2019) 1 and 27.

[34] Indirect taxes, including Value Added Tax and excise duties, may create an immediate obstacle to the free movement of goods and services and are harmonised on the basis of Art 113 TFEU.

[35] Case C-21/88 *Du Pont de Nemours Italiana v USL di Carrara* [1990] ECR I-889, para 20; see also Case C-18/84 *Commission v France* [1985] ECR 1339, para 13; Case T-359/04 *British Aggregates v Commission* [2010] ECR II-4227, para 91.

measures without their replacement with positive rules.[36] Thus, the most significant constraints on the fiscal sovereignty of MS are the primary free movement provisions and State aid rules.

2.1. Competences and Tax Sovereignty of the Member States

The right to impose taxes is based on the substantive and enforcement jurisdiction of a State. Substantive jurisdiction relates to the legitimacy of taxes, while enforcement jurisdiction comprehends the ability to collect taxes. Together they form the basis for determining the taxing power of a State.[37] These taxing powers are embodied in logical tax norms differentiating among taxpayers on the basis of justice considerations (e.g. ability to pay-principle), behavioural steering considerations (e.g. polluter pays principle), or various other considerations.[38] The jurisdiction of a State is usually asserted based on two criteria: the residence of the taxpayer and the source of his income. Due to the operation of individually designed tax systems, differences may occur concerning the treatment of resident compared to non-resident taxpayers and taxpayers with domestic compared to those with foreign-sourced income, liable to result in double taxation.[39] This is true at least in a traditional physical economy. The situation differs in a globalised and digitalised world, where goods and services easily move across borders, companies are active in countries without taxable presence there, and taxing rights are difficult to ascertain. Tax sovereignty and control is an essential element of the enforcement of State powers and can be defined as the autonomous power to introduce and enforce a tax system. Its goals are to ensure the financing of the public budget, the guarantee of the citizens' protection and welfare, and the execution of political and social policies.[40]

As can be inferred from Art 3 TFEU, direct taxation remains a sovereign competence of the MS. As opposed to indirect taxation (Art 113 TFEU), there is no explicit Treaty provision concerning the legislative power in the field of direct taxation. So far, the harmonisation of direct taxation on corporate income has been based on the flanking provision of Art 115

[36] Ben Terra and Peter Wattel, *European Tax Law, Fiscale Handboeken* (2nd edn, Kluwer Law International 2012) 38.
[37] Martijn Schippers and Constantijn Verhaeren, 'Taxation in a Digitizing World: Solutions for Corporate Income Tax and Value Added Tax' (2018) 27 EC Tax Review 61, 62.
[38] Thomas Jaeger, 'Part VII Tax Measures' in Franz Jürgen Säcker and Frank Montag (eds), *European State Aid Law: A Commentary* (Beck/Hart 2017) paras 4ff; Thomas Jaeger, 'Steuerliche Maßnahmen' in Franz Jürgen Säcker, Ulrich Karpenstein and Markus Ludwigs (eds), *Münchener Kommentar zum Wettbewerbsrecht Band 5: Beihilfenrecht* (4th edn, Beck 2022) paras 1ff.
[39] Paul Farmer, 'Direct Taxation and the Fundamental Freedoms' in Anthony Arnull and Damian Chalmers (eds), *The Oxford Handbook of European Union Law* (OUP 2015) 812.
[40] Claire Micheau, *State Aid, Subsidy and Tax Incentives Under EU and WTO Law* (Kluwer Law International 2014) 475-476.

TFEU,[41] which establishes an unanimity rule for the approximation of legislation directly affecting the establishment or functioning of the internal market. As a result, every further step towards harmonisation in direct taxation and the improvement of the internal market conditions requires a unanimous vote, which, in light of the differences between national tax policies, makes it difficult to achieve. Interestingly enough, Art 116 TFEU provides the Council, together with the European Parliament, with the possibility to adopt directives pursuant to the ordinary legislative procedure (majority vote) in case of a distortion of competition induced by differences between MS provisions. To date, Art 116 TFEU has not been resorted to for tax matters.[42]

Although direct taxation is not a harmonised area and MS have retained their sovereignty, this sovereignty is not absolute but has to be exercised in accordance with Union law and principles.[43] The ECJ has ruled in many instances that a State's taxing powers do not justify national rules, which result in the discrimination or unjustified restriction of activities covered by the fundamental freedoms.[44] This is especially true when national tax law discriminates on grounds of nationality concerning persons, goods, services or capital. Hence, MS are in principle free to design their national tax system, to the extent that they comply with Union law. In contrast, State aid control has been assigned to the EU with the Commission being in charge of ensuring compliance with the Treaty rules. Consequently, direct tax sovereignty and State aid law stand at a crossroads: On the one side, MS are free to exercise their tax powers; on the other side, State aid rules directly affect national tax systems. As will become evident, the recognition of this sovereignty is particularly evident in the area of justification. Justification is perhaps the most important part or issue in cases of direct taxation that are heard in court. The law is still developing as the Court continuously elaborates the scope and meaning of the justifications of the MS to safeguard their competence.

Former Advocate General (AG) Poiares Maduro got right to the point in observing that

[41] See eg Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States [2011] OJ L345/8 (concerning the allocation of dividends between parent and subsidiary companies).
[42] Claus Dieter Classen, 'Artikel 116 AEUV' in Hans von der Groeben, Jürgen Schwarze and Armin Hatje (eds), *Europäisches Unionsrecht Band III* (7th edn, Nomos 2015) para 35; Peter Wattel, 'Comparing Criteria: State Aid, Free Movement, Harmful Tax Competition and Market Distorting Disparities' in Isabelle Richelle, Wolfgang Schön and Edoardo Traversa (eds), *State Aid Law and Business Taxation* (Springer 2016) 61.
[43] Case C-279/93 *Schumacker* [1995] ECR I-225, para 21.
[44] See eg Case C-270/83 *Commission v France* [1986] ECR 273; Case C-330/91 *Commerzbank* [1993] ECR I-4017; Case C-484/93 *Svensson & Gustavsson* [1995] ECR I-3955; and more have followed.

> "[i]t is true that tax law is frequently dominated by legitimate concerns about legal certainty, deriving, in particular, from the need to guarantee the predictability of the financial burden imposed on taxpayers and the principle of no taxation without representation. However, a comparative analysis of the Member States' legal rules is sufficient to make it clear that such concerns do not exclude the use of certain general provisions and indeterminate concepts in the realm of tax law to prevent illegitimate tax avoidance. Legal certainty must be balanced against other values of the legal system. Tax law should not become a sort of legal 'wild-west' in which virtually every sort of opportunistic behaviour has to be tolerated so long as it conforms with a strict formalistic interpretation of the relevant tax provisions and the legislature has not expressly taken measures to prevent such behaviour."[45]

Furthermore, in its most recent case law on tax rulings, the Court has once again emphasised the sovereignty and competence of the MS in matters of direct taxation. It has stated that in non-harmonised areas of direct taxation, it is for the MS, in the exercise of their competence and with due regard to their tax autonomy, to lay down the characteristics that constitute the tax and define the reference system or 'normal' tax system against which the selectivity condition must be examined.[46]

2.2. General Tax Measures

A distinction must be made between general tax measures, which are covered by the MS' fiscal sovereignty and selective tax incentives, which give rise to proceedings under Art 107 TFEU. There is, however, no explicit legal definition of these two notions in the *acquis communautaire*.[47] Generally, MS raise revenue according to the individual's or corporation's income earned and his or its ability to pay based on specified indicators of individual capacity and defined rules for the calculation of the taxable amount. The constituent of a tax is twofold: First, its structural component necessitates the implementation of a structure. Second, the tax expenditure component consists in accomplishing government-spending objectives.[48]

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[45] Case C-255/02 *Halifax and Others* [2005] ECR I-01609, Opinion of AG Poiares Maduro, para 77.

[46] Joined Cases C-885/19 P and C-898/19 P, *Fiat Chrysler Finance Europe v Commission* [2022] ECLI:EU:C:2022:859, para 73; Case T-131/16 RENV *Belgium v Commission* [2023] ECLI:EU:T:2023:561, para 39, Joined Cases C-451/21 P and C-454/21 P *Luxembourg v Commission* [2023] ECLI:EU:C:2023:948, paras 112, 118, 154 and 177; Case C-457/21 P *Commission v Amazon.com and Others* [2023] ECLI:EU:C:2023:985, para 39.

[47] Wolfgang Schön, 'Taxation and State Aid Law in the European Union' (1999) 36 CMLR 911, 912; Phedon Nicolaides, Mihalis Kekelekis and Philip Buyskes, *State Aid Policy in the European Community: A Guide for Practitioners* (Kluwer Law International 2005) 25.

[48] See Joachim Englisch, 'Ability to Pay in European Tax Law' in Cécile Brokelind (ed), *Principles of Law: Function, Status and Impact in EU Tax Law* (IBFD 2014) 439-464.

General tax rules are not selective. They do not constitute aid or favour only certain undertakings or goods but the whole economy.[49] General tax measures are "measures pursuing general economic policy objectives through a reduction of the tax burden in relation to certain production costs (research and development, the environment, training, employment)."[50] A MS is free to organise, adapt and modify its general tax scheme. However, the notions of generality and selectivity do not necessarily exclude each other. The ECJ has held that a tax measure can be classified as selective State aid, even though it applies to a large number of undertakings.[51] As a result, selectivity may arise from the structural component of a tax in the shape of an advantage based on the legal form, size, public/private sector or financial/economic influence of an undertaking. It may also occur from a nationality or territoriality criterion. Moreover, it can be based on the activities carried out by a company.[52] Therefore, an *in concreto* analysis must determine whether or not a given measure is available to all or only a limited number of companies, including those belonging to different sectors of activity.

In consequence, selective measures as well as general measures may constitute State aid and affect competition, but on a different level. Accordingly, selective measures will affect competition rather on a national level, while general measures are more likely to have an impact on international tax competition.[53]

2.3. EU State Aid Rules – Arts 107 and 108 TFEU

The definition of the general prohibition of State aid and the relevant conditions for its assessment are laid down in Art 107(1) TFEU. Accordingly, State aid is

> "[…] any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods […], in so far as it affects trade between Member States […]."

Hence, the qualification of State aid requires the fulfilment of five cumulative conditions: A measure must be granted through the use of State resources or through State intervention (1), it

[49] Wolfgang Schön, 'Taxation and State Aid Law in the European Union' (1999) 36 CMLR 911, 917.
[50] Commission, 'Notice on the application of the State aid rules to measures relating to direct business taxation' OJ C384/3, 10 December 1998, para 13.
[51] Case C-279/08 P *Commission v Netherlands* [2011] ECR I-7671, para 50.
[52] Joachim Lang, *Systematisierung der Steuervergünstigungen: Ein Beitrag zur Lehre vom Steuerbestand* (Duncker & Humblot 1974) 74ff; Claire Micheau, *State Aid, Subsidy and Tax Incentives Under EU and WTO Law* (Kluwer Law International 2014) 222ff.
[53] Claire Micheau, 'Tax Selectivity in European Law of State Aid: Legal Assessment and Alternative Approaches' (2015) 40 European Law Review 323, 323.

must confer an economic advantage on the beneficiary undertaking (2), it must be selective (3), and it must distort or threaten to distort competition (4) affecting intra-Union trade (5).[54]

The first condition requires a transfer of State resources or funds, which may be a direct cash payment or an indirect transfer in which the State foregoes revenue, as is the case with tax measures.[55] It is sufficient that the aid is financed by public or private institutions designated or established by the State. In any case, there must be a financial burden for the State and the measure must be attributable to it.[56]

The second condition requires an economic advantage that would not have been available in the normal course of business.[57] The beneficiary's financial or economic position is improved or, where there has not been an actual improvement, the position did not deteriorate thanks to the aid. Hence, an advantage exists when the normal and usual burden of a company is reduced, which could not have been obtained under normal market conditions.[58] According to the Market Economy Operator Test, it can be assumed that no State aid is involved if the measure can be classified as a normal business transaction in which the State has behaved like a rational market economy operator and did not pursue any economic or social policy objectives.[59] The wording of Art 107(1) TFEU, namely that State aid is prohibited in any form whatsoever, indicates its broad concept. Indeed, the ECJ has long ago clarified that State aid not only encompasses direct positive benefits and subsidies but also tax measures mitigating the charges, which are normally included in a company's budget.[60] Here, the Commission and CJEU do not examine aid measures with regard to their form, but according to their effects.[61]

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[54] Case C-280/00 *Altmark Trans and Regierungspräsidium Magdeburg* [2003] ECR I-7747, para 75; Christoph Arhold, 'Part II Article 107 TFEU' in Franz Jürgen Säcker and Frank Montag (eds), *European State Aid Law: A Commentary* (Beck/Hart 2017) paras 103ff.
[55] Ulrich Schwalbe, 'Part I Introduction' in Franz Jürgen Säcker and Frank Montag (eds), *European State Aid Law: A Commentary* (Beck/Hart 2017) para 9.
[56] Case C-482/99 *France v Commission* [2002] ECR I-4397, para 24; Andreas Schwab, 'Part II Article 107 TFEU' in Franz Jürgen Säcker and Frank Montag (eds), *European State Aid Law: A Commentary* (Beck/Hart 2017) para 15.
[57] Ulrich Schwalbe, 'Part I Introduction' in Franz Jürgen Säcker and Frank Montag (eds), *European State Aid Law: A Commentary* (Beck/Hart 2017) para 10.
[58] 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' OJ C262, 19 July 2016, para 66.
[59] Case T-98/00 *Linde v Commission* [2002] ECR II-3961, para 49; Christoph Arhold, 'Part II Article 107 TFEU' in Franz Jürgen Säcker and Frank Montag (eds), *European State Aid Law: A Commentary* (Beck/Hart 2017) para 151.
[60] Case C-387/92 *Banco Exterior* [1994] ECR I-877, para 13; Joined Cases C-78/08 to C-80/08 *Paint Graphos* [2011] ECR I-7611, para 45.
[61] 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' OJ C262, 19 July 2016, para 67.

The third condition requires the advantage granted by the State be selective and benefit some companies more than others. This excludes general measures taken by a State that generally benefit all undertakings within the scope of that measure.[62] Selectivity thus serves to distinguish between the control of State aid and general economic policy in the MS. As already mentioned, the existence State aid is determined according to the effects-based doctrine, and this applies in particular to selectivity. The term selectivity is interpreted broadly. This means that legislation does not have to be explicitly selective, but that it is a matter of de facto selectivity, i.e. a scheme or measure that appears to be general but is actually restricted to certain undertakings or sectors of production. If the body granting the aid has a margin of discretion in its decision-making, concerning e.g. the choice of beneficiaries, the amount of aid or the conditions under which it is provided, the measure is normally considered selective.[63] The margin of discretion must be limited to reviewing the specified conditions in order to pursue the objective of the legislation and the criteria must be set out therein.[64] For example, tax rulings that simply interpret applicable tax law without departing from established administrative practice or case law are not selective, but provide legal certainty to the undertakings concerned. Over the years, and thanks to an increasing number of State aid cases before the CJEU, the selectivity assessment has become more complex. The so-called three-step test is applied to determine material selectivity, which consists of determining a reference system (1), against which a derogation is to be found (2), and possible justifications for such a derogation (3).[65] The three-step test and the selectivity test for tax aid are discussed in more detail in Chapter 3.

The advantage and selectivity criteria are interconnected, yet to be examined separately, which is not strictly adhered to in practice. Rather, both conditions are merged into the analysis of a 'selective advantage'.[66] The lack of distinction between the two criteria is a topic that could and should be dealt with separately and would, therefore, go beyond the scope of this research. The selectivity criterion as such poses already many problems and challenges in the traditional State aid analysis, the reason it is the central focus of this research.

[62] Ulrich Schwalbe, 'Part I Introduction' in Franz Jürgen Säcker and Frank Montag (eds), *European State Aid Law: A Commentary* (Beck/Hart 2017) para 11; the general definition of an undertaking can be found in Case C-41/90 *Höfner and Elser v Macrotron* [1991] ECR I-1979, para 21, "any entity engaged in an economic activity, regardless of the legal status of the entity and the way in which it is financed".
[63] Case C-241/94 *France v Commission* [1996] ECR I-4551, para 23; Christoph Arhold, 'Part II Article 107 TFEU' in Franz Jürgen Säcker and Frank Montag (eds), *European State Aid Law: A Commentary* (Beck/Hart 2017) paras 338ff.
[64] Case C-6/12 *P* [2013] ECLI:EU:C:2013:525, para 24.
[65] Christoph Arhold, 'Part II Article 107 TFEU' in Franz Jürgen Säcker and Frank Montag (eds), *European State Aid Law: A Commentary* (Beck/Hart 2017) paras 375ff.
[66] See recent cases such as Joined Cases T-755/15 and T-759/15 *Luxembourg v Commission* [2019] ECLI:EU:T:2019:670.

The fourth and fifth criteria require a (potential) impact on competition and trade through the allocation of State resources. The criteria are closely interlinked and often examined together. The Commission does not have to prove that there is an actual distortion of competition, but only has to examine whether the State aid is liable to distort competition. The same is true regarding the effect on trade. This is sufficiently fulfilled if it can be shown that the beneficiary is active in a market in which companies from other MS are also active.[67] In this respect, the ECJ has held that releasing an undertaking from the costs it would normally have to bear in its day-to-day management automatically leads to a distortion of competition and strengthening of its competitiveness.[68] Thereby, the chances of (foreign) undertakings to access the domestic market or enter the market at all are reduced. According to the De Minimis Regulation, a minimum volume of State aid of EUR 300,000 over a period of three years is considered permissible for a single undertaking, allowing an estimation of the impact on competition.[69] As regards the requirement of an appreciable effect on trade, it should be noted that neither the small amount of aid nor the small size of the undertaking receiving the aid are such as to preclude trade (or competition) from being affected.[70] Trade is considered to be affected whenever undertakings are competing in a given market within the EU.[71] As a result, the fourth and fifth criteria are usually presumed to be fulfilled and not subject to a deeper analysis.[72] Apart from the selectivity criterion, the other conditions are clear and usually fulfilled in the case of fiscal aid measures.[73]

According to Art 107(1) TFEU, any State aid that fulfils the five criteria listed above is to be considered incompatible with the internal market. The prohibition of State aid is not absolute though. In some circumstances, State intervention is necessary to offset market failures (i.e. inefficient market outcomes and results), or negative externalities (e.g. CO_2 emissions), and to preserve a well-functioning economy in general. However, politically undesirable results do

[67] Ulrich Schwalbe, 'Part I Introduction' in Franz Jürgen Säcker and Frank Montag (eds), *European State Aid Law: A Commentary* (Beck/Hart 2017) para 12; Ulrich Soltész, 'Part II Article 107 TFEU' in Franz Jürgen Säcker and Frank Montag (eds), *European State Aid Law: A Commentary* (Beck/Hart 2017) paras 453ff (distortion of competition) and paras 489ff (effect on trade between MS).
[68] See eg Case C-494/06 P *Commission v Italy and Wam* [2009] ECR I-3639, para 54.
[69] Commission Regulation (EU) 2023/2831 of 13 December 2023 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to de minimis aid [2023] OJ L2831.
[70] Case C-280/00 *Altmark Trans and Regierungspräsidium Magdeburg* [2003] ECR I-7747, para 81.
[71] Ulrich Soltész, 'Part II Article 107 TFEU' in Franz Jürgen Säcker and Frank Montag (eds), *European State Aid Law: A Commentary* (Beck/Hart 2017) para 494.
[72] These conditions are assumed to be fulfilled, see Commission, 'Report on the implementation of the Commission notice on the application of the state aid rules to measures relating to direct business taxation' C(2004) 434, 9 February 2004, para 22.
[73] Case C-66/14 *Finanzamt Linz* [2015] ECLI:EU:C:2015:242, Opinion of AG Kokott, paras 114-115.

not qualify as market failures if they prove to be economically efficient.[74] States provide aid to try to reach policy objectives, often mirroring the public or general interest. Tax incentives can play a crucial role in steering economic behaviour and efficiency. Nevertheless, State aid should only take place when the total welfare increases and goes beyond the cost of intervention.[75] An example for such beneficial support includes the aim to increase environmental standards or to encourage innovation where this would otherwise be prevented due to high costs or other factors. Another reason for intervention is to compensate for economic disparities between regions or to promote development. Next to this, governments invest in the preservation of national companies which would otherwise not survive against more competitive market players from other MS.[76] Many other reasons exist (e.g. information asymmetries or coordination problems between market actors, and the supply of services of general economic interest), which instigate governments to act.[77]

Undoubtedly, State aids can have beneficial effects and may be compatible with the internal market under the conclusive legal exemptions of Art 107(2) TFEU or the discretionary exemptions of Art 107(3) TFEU. The decision-making processes are standardised for many areas in the form of guidelines and frameworks. In practice, the Commission has developed three categories of exemptions, namely regional, horizontal and sectoral aid, which lift the general ban on State aid and partially summarise the exceptions of Art 107 TFEU. Regional aid falls under Art 107(3)(a) and (c) TFEU, which provides for aid to regions with a low income level or significant underemployment, as long as the support does not go against the common interest.[78] Horizontal rules are not limited to a specific economic sector, but may be granted to any company that fulfils the criteria, including aid for small and medium-sized enterprises, for research and development or for environmental protection.[79] The sectoral rules apply to

[74] Commission, 'Communication on EU State Aid Modernisation (SAM)' COM(2012) 209 final, 8 May 2012, para 12; Arthur Cecil Pigou, *The Economics of Welfare* (Macmillan 1920); see also Conor Quigley, *European State aid law and policy* (Hart 2015) 255; Ulrich Schwalbe, 'Part I Introduction' in Franz Jürgen Säcker and Frank Montag (eds), *European State Aid Law: A Commentary* (Beck/Hart 2017) paras 26ff.
[75] Herwig Hofmann and Claire Micheau, *State Aid Law of the European Union* (OUP 2016) 3.
[76] Oyabradoh Enodeh, 'The notion of (fiscal) State aid: decisions of the EU Commission and case law of the EU courts' (Tilburg University 2018) 1.
[77] For more on this see Hans Friederiszick, Lars-Hendrik Röller and Vincent Verouden, 'European State Aid Control: an economic framework' in Paolo Buccirossi (ed), *Handbook of Antitrust Economics* (MIT Press 2007); Ulrich Schwalbe, 'Part I Introduction' in Franz Jürgen Säcker and Frank Montag (eds), *European State Aid Law: A Commentary* (Beck/Hart 2017) paras 26ff.
[78] See also Commission, 'Guidelines on regional State aid' (Communication) OJ C153, 29 April 2021.
[79] See also Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty [2014] OJ L187.

economic sectors such as coal mining,[80] fisheries[81] or agriculture,[82] which the Commission has classified as sensitive due to long-standing economic problems.[83] There are also other categories of State aid: (a) aid having a social character (Art 107(2)(a) TFEU), (b) aid to make good the damage caused by natural disasters (Art 107(2)(b) TFEU), (c) aid that was intended for the former German regions to mitigate the negative consequences of the division of the country (Art 107(2)(c) TFEU), (d) aid to promote projects of European interest (Art 107(3)(b) TFEU) and (e) aid to preserve cultural heritage (Art 107(3)(d) TFEU). While the forms of aid listed in Art 107(2) TFEU are compatible *ex lege*, when the Commission approves State aid under Art 107(3) TFEU, it has a wide margin of discretion and carries out economic and social assessments. The Commission is required to weigh up the beneficial effects of the aid and its adverse effects on trading conditions and the maintenance of undistorted competition (balancing test).[84] The Commission has set out its State aid policy in various guidelines, notices and frameworks.[85] Moreover, Art 108(2) TFEU empowers the European Council upon request of a MS to determine types of State aid that are compatible with the Treaties. Additionally, the Commission is authorised to adopt block exemption regulations.[86] The General Block Exemption Regulation exempts specific categories of aid from the requirement of obligatory notification declaring them compatible with the internal market.[87] This is also true for aid not exceeding a certain amount (de minimis aid).[88] If the conditions of these regulations are not met, the aid will not be automatically void, but subject to the normal notification requirement.

Under Art 108 TFEU, the Commission is given the exclusive competence to enforce Art 107 TFEU and decide on the compatibility of the State aid granted with the internal

[80] See Council Decision of 10 December 2010 on State aid to facilitate the closure of uncompetitive coal mines [2010] OJ L336.
[81] Commission, 'Guidelines for State aid in the fishery and aquaculture sector' (Communication) OJ C107, 23 March 2023.
[82] Commission, 'Guidelines for State aid in the agricultural and forestry sectors in rural areas' (Communication) OJ C485, 21 December 2022.
[83] Ulrich Schwalbe, 'Part I Introduction' in Franz Jürgen Säcker and Frank Montag (eds), *European State Aid Law: A Commentary* (Beck/Hart 2017) paras 13-20.
[84] Joined Cases T-371/94 and T-394/94 *British Airways and Others v Commission* [1998] ECR II-2405, para 283.
[85] Viktor Kreuschitz 'Part II Article 107 TFEU' in Franz Jürgen Säcker and Frank Montag (eds), *European State Aid Law: A Commentary* (Beck/Hart 2017) paras 543ff.
[86] Art 108(4) TFEU in conjunction with Art 109 TFEU.
[87] Eg environmental protection, research and development, regional aid, etc, see Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty [2014] OJ L187.
[88] See Commission Regulation (EU) 2023/2831 of 13 December 2023 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to de minimis aid [2023] OJ L2831; Commission Regulation (EU) 2023/2832 of 13 December 2023 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to de minimis aid granted to undertakings providing services of general economic interest [2023] OJ L2832.

market.[89] Only the MS concerned is a party to the administrative proceedings before the Commission. The implementation of State aid is subject to prior notification to and authorisation by the Commission, encompassing the MS' standstill obligation.[90] A distinction is made between existing (before accession to the EU or entry into force of the State aid rules) and new aid (reported according to Art 108(3) TFEU). The Commission authorises aid by means of a decision pursuant to Art 288 TFEU. The decision may relate to notified or unnotified aid. If the aid is found to be incompatible, the Commission may decide on its abolishment or alteration, including its recovery.[91] If the doubts as to the compatibility of the aid are removed or if not all the criteria of Art 107 TFEU are fulfilled, the Commission may ultimately declare the aid compatible with the internal market (positive decision).[92] After giving the MS an opportunity to submit its observations, the Commission may adopt a decision requiring the MS to suspend or temporarily recover any unlawful aid until it has taken a decision.[93] The Commission closes the preliminary investigation by adopting a decision finding no State aid, raising no objections or opening a formal procedure.[94] In any case, the Commission must state reasons in its decision pursuant to Art 296 TFEU. A formal investigation procedure is initiated if the Commission has serious doubts as to the compatibility of the aid with Art 107 TFEU or if it encounters procedural difficulties in obtaining information. MS and interested parties are again invited to submit comments. There is no statutory deadline for the Commission's final decision. The decision can be either positive (i.e. no aid or compatible aid), conditional (i.e. compatible aid, but with obligations attached) or negative (i.e. incompatible aid).[95] Any unlawful State aid has to be paid back retrospectively for a period of ten years plus interest ('recovery case'). The aim is not punitive, but to restore the situation that existed before the aid was granted.[96] To ensure an effective recovery, however, MS may be threatened with substantial penalty payments in case of failure to conform.[97] Up to this date, State aid law does

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[89] See also Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union [2015] OJ L248/9.
[90] Art 108(3) TFEU.
[91] Viktor Kreuschitz 'Part II Article 107 TFEU' in Franz Jürgen Säcker and Frank Montag (eds), *European State Aid Law: A Commentary* (Beck/Hart 2017) paras 591ff.
[92] Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union [2015] OJ L248/9, Art 9(3).
[93] Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union [2015] OJ L248/9, Arts 11 and 13(1).
[94] Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union [2015] OJ L248/9, Art 15(1) in conjunction with Arts 4(2), (3) or (4).
[95] Viktor Kreuschitz 'Part II Article 107 TFEU' in Franz Jürgen Säcker and Frank Montag (eds), *European State Aid Law: A Commentary* (Beck/Hart 2017) paras 591ff.
[96] Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union [2015] OJ L248/9, Arts 16 and 17(1).
[97] Case C-184/11 *Commission v Spain* [2014] ECLI:EU:C:2014:316.

not clearly provide for the protection of legitimate expectations or legal certainty of affected undertakings, a plea commonly invoked against recovery orders, although these principles are general EU law principles.[98] Quite the contrary, the GC has ruled that where the conduct of a national authority usually responsible for applying EU law acts in breach, this cannot give rise to legitimate expectations of the favourable treatment.[99] In any case, the decisions taken by the Commission are subject to judicial review by the CJEU.[100]

2.4. Fundamental Freedoms and Free Movement Provisions – Negative Integration

In direct taxation matters, the fundamental freedoms as interpreted by the CJEU constitute a powerful tool for removing internal market barriers and thereby driving tax integration. The four fundamental freedoms (free movement of goods, persons, services and capital) are all based on the underlying principle of non-discrimination enshrined in Art 18 TFEU.[101] The free movement provisions include the right of EU citizens to move and reside freely within the EU (Art 21(1) TFEU), the free movement of goods (Arts 30, 34 and 35 TFEU), the free movement of persons and the freedom of establishment (Art 45 and 49 TFEU), the freedom to provide services (Art 56 TFEU) and the free movement of capital and payments (Art 63 TFEU). The fundamental freedoms have direct effect, are directly applicable and can thus be relied upon by individuals in front of national courts.[102] They are recognised as general principles of EU law and are protected by the EU Charter of Fundamental Rights (CFR).[103] The application of all fundamental freedoms requires a cross-border situation as a prerequisite. The primary law provisions demand from MS to remain neutral as to cross-border activities by omitting any discrimination between domestic and cross-border situations, including both restrictions and selective incentives. Moreover, fundamental freedoms do not distinguish between general and specific measures.[104]

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[98] See Commission, 'Notice on the recovery of unlawful and incompatible State aid' (Communication) OJ C247, 23 July 2019, para 2.4.1.2.; cf Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union [2015] OJ L248/9, Art 16(1); Juan Salvador Pastoriza, 'The Recovery Obligation and the Protection of Legitimate Expectations: The Spanish Experience' in Isabelle Richelle, Wolfgang Schön and Edoardo Traversa (eds), *State Aid Law and Business Taxation* (Springer 2016) 249ff; Cláudia Saavedra Pinto, 'The 'narrow' meaning of the legitimate expectations principle in State aid law versus the foreign investor's legitimate expectations' (2016) EStAL 270, 273ff.

[99] Case T-620/11 *SinnLeffers v Commission* [2016] ECLI:EU:T:2016:59, para 191; the Commission's practice and CJEU's case law are inconsistent concerning recovery obligations and the protection of legitimate expectations and legal certainty.

[100] For more see Herwig Hofmann and Alessandro Morini, 'Judicial Review of Commission Decisions in State Aid' in Erika Szyszczak (ed), *Research Handbook on European State Aid Law* (Edward Elgar 2012) 354ff.

[101] Thomas Jaeger, *Einführung in das Europarecht* (4th edn, Facultas 2023) 148.

[102] Thomas Jaeger, *Einführung in das Europarecht* (4th edn, Facultas 2023) 148ff.

[103] See in particular preamble and Arts 45 and 53 CFR.

[104] Thomas Jaeger, *Einführung in das Europarecht* (4th edn, Facultas 2023) 148ff.

The present analysis focuses on the free movement of workers, the freedom of establishment, the freedom to provide services and the free movement of capital. Chapter 4 explains these individual fundamental freedoms in more detail and analyses the related case law. No further attention is paid to free movement of goods, as in principle only indirect taxes are levied on them, which are not part of the subject matter of the thesis.

In establishing an infringement of the fundamental free movements, the CJEU adopts a four-step approach. First, it examines whether a measure falls within the scope of the freedoms at all and if so, the scope of which freedom. At this stage, the existence of a cross-border element and entitled person (natural or legal person of a MS) is established. Additionally, it will be determined whether any more specific secondary law exists for the measure at hand (which will precede).[105] The second step involves the analysis of whether a State-attributable measure prima facie discriminates between objectively comparable cross-border and domestic situations or otherwise restricts the exercise of the freedom. Thus, the violation of a fundamental market freedom requires discriminatory behaviour by a MS. In other words, the Court checks whether the entitled person or company is punished for exercising its free movement rights by either the host or home State. Some authors are in favour of dividing this test step into two: on the one hand, determining unequal treatment of two groups and, on the other hand, determining whether both groups are in a comparable situation at all.[106] However, this makes little sense, as a comparative factor must already be selected when determining unequal treatment and therefore both situations are automatically compared, albeit possibly in less depth than envisaged in the second step. The objective comparability of the facts or situations is difficult to handle. This test is to be understood as a kind of evidence test in which it is determined whether the unequal treatment is obviously based on a convincing objective reason. If this is the case, the situations are not comparable. The ECJ uses both vertical and horizontal comparability tests. This means that it compares not only resident and cross-border situations, but also different types of cross-border situations. This does not mean that the legislator has no room for manoeuvre to provide for differentiated regulations for cross-border situations. Residents and non-residents as well as residents with domestic and foreign income are by no means generally and always in a comparable situation. Therefore, taxpayers who find themselves in different cross-border situations are by no means generally comparable. Comparability must always be given with regard to the legal or at least the actual situation of the specific case. The comparability test is

[105] Thomas Jaeger, *Introduction to European Union Law* (2nd edn, Facultas 2024) 205ff.

[106] Eg Juliane Kokott and Lars Dobratz, 'Der unionsrechtliche allgemeine Gleichheitssatz im Europäischen Steuerrecht' in Wolfgang Schön and Caroline Heber (eds), *Grundfragen des Europäischen Steuerrechts* (Springer 2015) 34.

therefore by no means free of value judgements.[107] In theory, the evaluation of comparability belongs to the second step of the analysis. However, as this thesis develops, it will become evident that there is no definitive framework for determining when and where this assessment should take place. The level at which the assessment occurs varies depending on the specific freedom being examined. As a third step, it will be assessed whether a discriminating or restricting measure can be justified on the basis that it pursues a legitimate objective and is justified by imperative reasons in the public interest. Hence, the measure must be explained by objective differences in light of the object and purpose of the national law.[108] If this is true, it will lastly in a fourth step be examined whether the measure is exercised in an appropriate and proportionate manner, i.e. whether it is suitable to achieve the aim and does not go beyond what is necessary for its achievement.[109] Often, the examination of whether national law infringes fundamental freedoms is divided into three steps by merging the third and fourth step above, i.e (i) scope of protection of the fundamental freedom, (ii) restriction of a fundamental freedom and (iii) justification of the restriction.[110] However, proportionality is an important separate component of the analysis, as measures may be justified but may be disproportionate and therefore fail the test. For this reason, the author adheres to the original four-level categorisation.

From an EU law perspective, the fundamental freedoms do not come into effect in a purely domestic situation. State aid provided to domestic undertakings does not fall within their scope if no foreign businesses are concerned by the tax in question and the measure only shifts the tax burden among domestic taxpayers.[111] Thus, such measures may constitute State aid within the meaning of Art 107 TFEU but do not entail discrimination or a restriction vis-à-vis foreign companies due to the absence of a cross-border element. Next to this, no violation of fundamental freedoms is triggered when a MS gives preferential treatment to foreign capital and companies trying to attract foreign investment.[112] This phenomenon is called reverse

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[107] Michael Lang, 'Jüngste Tendenzen zur „horizontalen" Vergleichbarkeitsprüfung in der steuerlichen Rechtsprechung des EuGH zu den Grundfreiheiten' (2011) 4 Steuer und Wirtschaft International 154.

[108] Peter Wattel, 'State Aid, Free Movement, Harmful Tax Competition and Disparities' in Isabelle Richelle, Wolfgang Schön and Edoardo Traversa (eds), *State Aid Law and Business Taxation* (Springer 2016) 62.

[109] See also Ben Terra and Peter Wattel, *European Tax Law, Fiscale Handboeken* (2nd edn, Kluwer Law International 2012) 59-64.

[110] See eg Florian Haase, *Internationales und Europäisches Steuerrecht* (7th edn, C F Müller 2023) para 828.

[111] Wolfgang Schön, 'Taxation and State Aid Law in the European Union' (1999) 36 CMLR 911, 917.

[112] Commission, 'Towards Tax Coordination in the European Union: A Package to Tackle Harmful Tax Competition' (Communication) COM(97) 495 final, 15 October 1997, Annex B; Carlo Pinto, 'EU and OECD to Fight Harmful Tax Competition: Has the Right Path Been Undertaken?' (1998) 26 Intertax 386, 394ff.

discrimination and does not pose a problem of EU law but rather domestic law (in line with the principle of subsidiarity).[113]

The potential for conflict of direct taxation matters with the fundamental freedoms is significant. As previously mentioned, CJEU case law requires MS to exercise their sovereign direct taxation competence in line with EU law, i.e. respecting the fundamental freedoms.[114] Since its landmark judgement *Avoir Fiscal*[115] and thanks to a subsequent flow of similar cases, direct tax cases have become an important constituent of CJEU case law. The area of direct taxation can be regarded as particularly complex and challenging due to the intricacy of national tax law and the interaction of different systems. This requires a heavy task, namely finding the right balance between the application of fundamental freedoms and the protection of sovereign taxing rights.

In principle, the fundamental freedoms apply alongside each other, i.e. several fundamental freedoms can apply to a situation at the same time, so to speak offering cumulative protection for the different dimensions. In particular in the relationship between the freedom of establishment and the free movement of capital, one or the other may take precedence on a case-by-case basis. If none of the specific fundamental freedoms is relevant, the general prohibition of discrimination in Art 18 TFEU applies on a subsidiary basis. It should also be noted that the fundamental freedoms take precedence over the provisions of double tax conventions (DTCs) when it comes to tax measures.[116]

The assessment of direct tax measures under the fundamental freedoms is closely linked to the assessment of tax aid under State aid law. In particular, the hypothesis arises that the non-discrimination methodology applied in the context of the fundamental freedoms significantly influences the selectivity approach. This overlap suggests a convergence between the two concepts. The methodologies involve analysing whether tax rules create unjustified distinctions or confer selective advantages, thereby distorting competition. The non-discrimination approach of the fundamental freedoms resonates with and has likely shaped the second step (i.e. comparability) of the selectivity test. Moreover, there are further parallels in the differentiated justifications for differential treatment and the recognition of overriding reasons in the general interest. In the following chapters, it will become clear that this convergence reflects a desirable

[113] For more on this see Astrid Epiney, *Umgekehrte Diskriminierungen* (Heymann 1995).
[114] Case C-270/83 *Commission v France* [1986] ECR 273, para 13.
[115] Case C-270/83 *Commission v France* [1986] ECR 273.
[116] Florian Haase, *Internationales und Europäisches Steuerrecht* (7th edn, C F Müller 2023) 580.

trend, that uniform principles are being integrated to ensure fairness and coherence while fostering the harmonisation of analytical tools.

2.5. Interplay and Overlap of State Aid Rules and Fundamental Freedoms

Like competition law and public procurement law, State aid law is based on the fundamental freedoms of the TFEU.[117] In general, it cannot be ruled out that a tax measure falls under both the fundamental freedoms and the State aid scope. MS' interventions can be organised in a way that affects the scope of other Treaty provisions, as well as Art 107 TFEU. Next to the State aid rules, prohibitions on certain levies (Arts 30, 110 and 111 TFEU), the free movement of goods (Arts 34 and 35 TFEU), the free movement of persons (Art 45 TFEU), the freedom of establishment (Art 49 TFEU), the freedom to provide services (Art 56 TFEU), the free movement of capital (Art 63 TFEU) as well as the other competition rules of Arts 101ff TFEU may also be affected. They all pursue the same objective, namely to prevent distortions of competition, but can be applied in parallel with the State aid rules, as they have different criteria and legal consequences.[118] The ECJ has previously held that a measure falling under the State aid provisions is not exempted from the prohibition of a directly applicable Treaty provision.[119] The finding by the Commission that a measure is indeed compatible with the internal market does not preclude it from conflicting with the fundamental freedoms. Accordingly, the Commission has to consider other applicable provisions, which could potentially be infringed by the aid before assessing its compatibility. As such, State aid cannot be declared compatible with the market if it conflicts with other Treaty provisions.[120] The CJEU reiterated that, a fortiori, a State aid procedure must not lead to a result contrary to other specific Treaty rules if those provisions pursue the objective of undistorted competition.[121] Conversely, this means that State aid whose purpose, modalities or the economic activity for which it is granted are inextricably linked to a breach of EU law (e.g. environmental law) must be prohibited. If there is no such inextricable link, State aid that has harmful effects in certain areas (e.g. on the

[117] Franz Jürgen Säcker, 'Part I Introduction' in Franz Jürgen Säcker and Frank Montag (eds), *European State Aid Law: A Commentary* (Beck/Hart 2017) paras 1-2.
[118] Andreas Schwab, 'Part II Article 107 TFEU' in Franz Jürgen Säcker and Frank Montag (eds), *European State Aid Law: A Commentary* (Beck/Hart 2017) para 35.
[119] Case C-21/88 *Du Pont de Nemours Italiana v USL di Carrara* [1990] ECR I-889, para 20; cf Case C-156/98 *Germany v Commission* [2000] ECR I-6857, para 78.
[120] Case C-156/98 *Germany v Commission* [2000] ECR I-6857, para 78; cf Joined Cases T-713/22 and T-720/22 *Portumo – Madeira and Others v Commission (Zone franche de Madère)* [2024] ECLI:EU:T:2024:775, paras 100-103.
[121] Case T-511/09 *Niki Luftfahrt v Commission* [2015] ECLI:EU:T:2015:284, para 215; cf Case C-594/18 P *Austria v Commission (Hinkley Point)* [2020] ECLI:EU:C:2020:742, paras 44 and 100; Case T-101/18 *Austria v Commission* [2022] ECR-728, para 78, pending before the ECJ Case C-59/23 P.

environment) may not be prohibited if these effects do not constitute an obstacle to free movement.[122]

While the Commission may assess the compatibility of a measure taken by a MS with the State aid provisions and other Treaty provisions pursuant to Art 108 TFEU, this is not the case for the courts of the MS. The State aid provisions are not directly applicable, with the exception of the last sentence of Art 108(3) TFEU. Only the Commission is authorised to assess such compatibility, subject to review by the CJEU.[123] The review of State aids and fundamental freedom infringements is usually separated adhering to the principal of conferral and the Commission's attributed competence.[124] In *Iannelli & Volpi*, the Court formulated the severability test differentiating the assessment of an infringement of the fundamental freedoms from that of State aid rules where significant overlaps occur by holding that

> "[t]hose aspects of aid which contravene specific provisions of the Treaty other than Articles [107 TFEU] and [108 TFEU] may be so indissolubly linked to the object of the aid that it is impossible to evaluate them separately so that their effect on the compatibility or incompatibility of the aid viewed as a whole must therefore of necessity be determined in the light of the procedure prescribed in Article [108 TFEU]. […] Nevertheless the position is different if it is possible when a system of aid is being analysed to separate those conditions or factors which, even though they form part of this system, may be regarded as not being necessary for the attainment of its object or for its proper functioning. […]"[125]

From this wording, it seems that the Court allows State aid rules to overrule the fundamental freedoms unless free movement concerns are separable from the aid measure. Only those aspects of the aid, which are not necessary for the attainment of its object or functioning can indeed be held incompatible with another Treaty provision, without prejudice to State aid control. Hence, those aspects are subject to a different review and procedure compared to the aid as such.[126] Thus, national courts are not entitled to examine the compatibility of the aid

[122] Case C-284/21 P *Commission v Braesch and Others* [2023] ECLI:EU:C:2023:58, paras 98-103; Phedon Nicolaides, 'Must the Commission Prohibit State Aid That Harms the Environment?' (2023) EStAL 17, 25; Marcus Klamert and Franz Koppensteiner, 'Is State Aid Law a Self-Contained Regime Within EU Law?' (2023) EStAL 234.
[123] Andreas Schwab, 'Part II Article 107 TFEU' in Franz Jürgen Säcker and Frank Montag (eds), *European State Aid Law: A Commentary* (Beck/Hart 2017) paras 36ff.
[124] Cf Case C-156/98 *Germany v Commission* [2000] ECR I-6857, Opinion of AG Saggio, paras 42-44.
[125] Case C-74/76 *Iannelli v Meroni* [1977] ECR 557, para 14.
[126] On the basis of Art 258 TFEU, see Commission, 'Notice on the application of the State aid rules to measures relating to direct business taxation' OJ C384/3, 10 December 1998, para 29; see also Andrea Biondi and Piet

measure with other provisions. They can only do so for particularities of the aid, which can be isolated and are not indispensable for the aid's purpose. If this is not possible, only the Commission (and subsequently the CJEU) may assess the measure.[127] A similar reasoning was applied in a subsequent decision concerning an environmental tax imposed on ships and aircrafts arriving to Sardinia (infringement of the freedom to provide services and of State aid law simultaneously).[128] In its more recent *A-Fonds* judgment, the ECJ held that national courts are not competent to assess a measure's compatibility with the fundamental freedoms, if that measure constitutes aid. The case concerned a dividend withholding tax refund claim by a German investment fund, A-Fonds, subject to 15% withholding tax on its Dutch-sourced dividends. Under Dutch law, a refund of withholding tax on dividends was available only to Dutch public undertakings. Hence, the request by A-Fonds was denied for the lack of an establishment in the Netherlands. The Court of Appeal in 's-Hertogenbosch found the requirement of residence to be an infringement of the free movement of capital under Art 63(1) TFEU, but referred a question on whether that decision was actually compliant with the State aid rules.[129] The Court ruled that, irrespective of a parallel infringement of the fundamental freedoms, the Commission has the exclusive competence to evaluate the compatibility of aid with the internal market. It added however, thereby repeating its *Iannelli & Volpi* line of reasoning, that national courts may assess certain aspects of the aid measure in light of the fundamental freedoms, to the extent that those features can be examined separately and are not necessary for the achievement of the objective or functioning of the aid.[130] The Court concluded that the aid, the withholding tax refund based on Dutch residence, was indissolubly linked to its object. Consequently, the Dutch court was precluded from assessing whether the residence condition complies with the free movement of capital, where the refund scheme constitutes State aid.[131]

The application in practice of the severability test is difficult to perform, since it cannot always be clearly established which elements of an aid measure are linked to its object and which not.

Eeckhout, 'State Aid and Obstacles to Trade' in Andrea Biondi, Piet Eeckhout and James Flynn (eds), *The Law of State Aid in the European Union* (OUP 2004) 107-111.

[127] Andreas Schwab, 'Part II Article 107 TFEU' in Franz Jürgen Säcker and Frank Montag (eds), *European State Aid Law: A Commentary* (Beck/Hart 2017) paras 35ff.

[128] Case C-169/08 *Presidente del Consiglio dei Ministri* [2009] ECR I-10821; see also Mélanie Staes, 'The Combined Application of the Fundamental Freedoms and the EU State aid Rules: In Search of a Way Out of the Maze' (2014) 42 Intertax 106, *passim*.

[129] Case C-598/17 *A-Fonds* [2019] ECLI:EU:C:2019:352, paras 12-32.

[130] Case C-598/17 *A-Fonds* [2019] ECLI:EU:C:2019:352, paras 46-47; see also Case T-268/21 *Ryanair v Commission (Italie; regime d'aide; Covid-19)* [2023] ECLI:EU:T:2023:279, para 22.

[131] Case C-598/17 *A-Fonds* [2019] ECLI:EU:C:2019:352, paras 49 and 54; see also Christos Nikolaos Kalykas, 'Selectivity and Proportionality: Can State Aid Control Learn from the Free Movement Rationale?' (2023) EStAL 42.

On a different note, the Court has held that the principle of severity becomes limited or even inapplicable in cases where a measure is governed by both State aid law and another Treaty rule pursuing the same objective, when one of them is more specific. In such a dual infringement case, the more specific infringement (*lex specialis*) prevails, which in the CJEU decision required a compatibility assessment of the measure with the other Treaty rule (and not with Arts 107 and 108 TFEU).[132] Hence, the national courts must fulfil the task of determining the more or most specific infringement. To sum up, the joint review of aid measures and the infringement of fundamental freedoms is only possible to the extent that, in the course of State aid procedures, this other Treaty rule (the fundamental freedom) is indissolubly linked with the functioning of that aid.

The Court has not yet clarified which consequences and legal remedies result from a cumulative application of both sets of rules and the possible double infringement.[133] As outlined above, the breach of Art 107 TFEU leads to a negative Commission decision and the recovery of aid from all undertakings having received the benefit (up to ten years retroactively). Thus, the advantage is removed and the situation is neutralised.[134] In contrast, under the fundamental freedoms, MS may be required to extend the beneficial rule to all taxpayers.[135] AG Kokott summarised it as follows: " […] the national courts have a duty to give general and comprehensive effect to the prohibition on putting into effect proposed State aid and, in so doing, must also take full account of the interests of the European Union."[136] Accordingly, the national court must ensure the protection of individual rights and at the same time give effect to the prohibition of the third sentence of Art 108(3) TFEU.[137] Despite the efforts of the Court to clarify the situation of the simultaneous application and overlap of State aid law and the fundamental freedoms, the precise contours of that relationship between remain difficult to discern. The interplay between the two is to some extent determined by their severability. However, the provisions inherently serve the

[132] Case C-91/78 *Hansen* [1979] ECR 935, paras 9-11; Case C-73/79 *Commission v Italy* [1980] ECR 1533, para 8; see also Pierpaolo Rossi-Maccanico, 'EU Review of Direct Tax Measures: Interplay between Fundamental Freedoms and State Aid Control' (2013) 22 EC Tax Review 19, *passim*; Christiana Panayi, *Advanced Issues in International and European Tax Law* (Hart 2015) 249-252.
[133] See eg Case C-66/14 *Finanzamt Linz* [2015] ECLI:EU:C:2015:242, Opinion of AG Kokott, para 4.
[134] Alexandra Miladinovic, 'The State Aid Provisions of the TFEU in Tax Matters' in Michael Lang and others (eds), *Introduction to European Tax Law on Direct Taxation* (6th edn, Linde 2020) 114.
[135] Michael Lang, 'Seminar J: Steuerrecht, Grundfreiheiten und Beihilfeverbot' (2010) 15 Internationales Steuerrecht 570, 578ff.
[136] Case C-66/14 *Finanzamt Linz* [2015] ECLI:EU:C:2015:242, Opinion of AG Kokott, para 30.
[137] Case C-66/14 *Finanzamt Linz* [2015] ECLI:EU:C:2015:242, Opinion of AG Kokott, para 30.

same purpose, namely the promotion of the internal market, making it almost impossible to fully delineate their application.[138]

2.6. Developments Affecting EU Fiscal State Aid Control

In addition to the possibilities under primary law and case law, various actions and soft law have led to further development of the EU's State aid control. What must not be neglected is the ever-growing trend of globalisation and digitalisation, which has encouraged and intensified tax competition and the establishment of preferential tax regimes. Especially the mobility of tax bases across national borders comprising profits shifting and base erosion practices by MNEs causes great concern. Several actions have been undertaken on the European but also international level to tame harmful tax competition and to align the approach and rules of direct taxation. Such developments and efforts have also resulted in the adjustment and reinforcement of fiscal State aid control.

2.6.1. Progressive Shaping of a Commission State Aid Policy

Apart from the State aid tool of primary law, the Commission has gradually increased its use of soft law instruments: Several guidelines, frameworks, communications, notices and codes have been adopted to structure and complement the normative approach in the State aid regime.[139] Notwithstanding the non-binding nature of soft law, the Commission is bound by its own general acts from which it may not depart in individual cases without justifying reasons.[140] Within the context of fighting harmful tax competition and avoidance, the Commission started to systematically apply State aid rules to taxation on the basis of these various soft law instruments. In this regard, Joaquín Almunia, former Commission Vice-President and Commissioner for Competition, explained that

> "[t]he reason to tackle taxation from the State aid standpoint is simple. Selective taxation is economically inefficient, because it distorts the level playing field for the allocation of capital within the internal market. This is particularly the case for the digital, creative, and other industries based on intellectual property. In these sectors, it is easier for companies to push activities from one country to another and take advantage of the gaps that exist within the EU."[141]

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[138] Cf Andrea Biondi, 'State aid and free movement' in Leigh Hancher and Juan Jorge Piernas López (eds), *Research Handbook on European State Aid Law* (2th edn, Edward Elgar 2021) 87-102.
[139] Soft law instruments are not legally binding, see Art 288 TFEU.
[140] Case C-189/02 P *Dansk Rørindustri and Others v Commission* [2005] ECR I-5425, paras 207-211.
[141] Joaquín Almunia, 'Fighting for the Single Market' (Speech at the European Competition Forum, 11 February 2014) <https://ec.europa.eu/commission/presscorner/detail/en/SPEECH_14_119> accessed 17 September 2024.

In 1997, the Economic and Financial Affairs Council (ECOFIN) meeting, composed of the national economics and finance ministers, resulted in the adoption of the 1998 Code of Conduct for Business Taxation. Since the Code of Conduct was not issued by the Commission, it is not legally bound by it. Its purpose is to establish factors for the identification of harmful tax practices and to encourage MS to abolish them. MS are required to refrain from introducing harmful tax measures ('standstill obligation') and to amend existing laws and practices that are deemed to be harmful considering the principles laid down in the Code of Conduct ('rollback obligation').[142] The Code of Conduct can, thus, be considered the EU counterpart to the OECD Project on Harmful Tax Practices of 1998.[143] In its resolution, the Council notes that certain tax measures covered by the Code of Conduct may also fall within the scope of the State aid provisions.[144] This, however, does not affect the parallel qualification of a tax measure as harmful under the Code of Conduct and as State aid under the Treaty provisions.[145] Despite the soft law character of the Code of Conduct, its political force has led to the issuance by the Commission of the 1998 Notice on the application of the State aid rules relating to direct business taxation. The Notice specifies that tax benefits restricted to intragroup activities and discretionary administrative practices could be deemed as State aid. Especially the non-transparent administrative decisions, tax rulings included, give rise to concern.[146]

In the aftermath of the 1998 Notice, the Commission launched its State Aid Action Plan for the period 2005-2009 as a measure to reform the legal framework and to have less and better targeted State aid. The goal was to have less and better targeted State aid, favouring measures of common European interest and horizontal aid instead of sectoral aid.[147] In May 2012, the Commission implemented its State Aid Modernisation project, another reform of EU State aid control, as part of the Europe 2020 Strategy. Its aim is to increase administrative efficiency, provide for more predictable rules and concentrate on cases with a potentially large impact on competition.[148] Hence, the modernisation of State aid rules foresees a fostered sustainable growth in the internal market, a strengthened cooperation between MS in the State aid

[142] Council, 'Conclusions of the ECOFIN Council Meeting on 1 December 1997 concerning taxation policy' (Resolution) OJ C2, Annex 1 paras C and D.
[143] Ruth Mason, 'Tax Rulings as State Aid FAQ' (2017) 154 Tax Notes 451, 458.
[144] Council, 'Conclusions of the ECOFIN Council Meeting on 1 December 1997 concerning taxation policy' (Resolution) OJ C2, Annex 1 para J.
[145] Commission, 'Notice on the application of the State aid rules to measures relating to direct business taxation' OJ C384/3, 10 December 1998, para 30.
[146] Commission, 'Notice on the application of the State aid rules to measures relating to direct business taxation' OJ C384/3, 10 December 1998, paras 20ff.
[147] Commission, 'State Aid Action Plan on less and better targeted state aid: a roadmap for state aid reform 2005-2009' COM(2005) 107 final, 7 June 2005.
[148] Commission, 'EU State Aid Modernisation (SAM)' (Communication) COM(2012) 209 final, 8 May 2012.

enforcement and the adoption of faster and streamlined decisions.[149] To that effect, the Commission has adopted new State aid standards, among which the Notice on the notion of State aid has been published in July 2016. The aim of the 2016 Notice is to clarify the overall State aid situation and key concepts relating to Art 107(1) TFEU and to align them with the more economic and effects-based approach of the Commission.[150] It should be understood as the Commission's codification and interpretation of the CJEU's case law and as a summary of its own evolved approach and legal reasoning.[151] Nevertheless, despite the aim of bringing about more clarity and legal certainty, it rather confirms the broad State aid framework and its ambiguities.

More importantly and as will be further discussed below, the CJEU has extensively interpreted the concept of State aid over the last years leading to a more intrusive Commission State aid policy, influencing the MS' economic and fiscal policies.

2.6.2. EU Secondary Law – Directives and Proposals on Company Taxation

As previously mentioned, the harmonisation of direct tax law is not foreseen in the Treaties, which explains why there is no bulk of secondary law in this area, especially no harmonising regulations.[152] However, in order to eliminate internal market obstacles, some common rules are indispensable. MS have realised this (albeit to varying degrees), leading to the adoption of company tax legislation in the form of directives based on Art 115 TFEU, which authorises the EU to issue directives for the approximation of laws, regulations or administrative provisions of the MS that directly impact the internal market.

Proposals for the harmonisation of direct taxes have been the subject of discussion for decades. The Neumark Report of 1962 recommended harmonising tax systems and financial policies to create tax conditions similar to those in a unified economy.[153] The Committee considered it desirable to levy the same type of uniform income tax in all MS, with the same structure of

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[149] Commission, 'EU State Aid Modernisation (SAM)' (Communication) COM(2012) 209 final, 8 May 2012, para 8.

[150] 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' OJ C262, 19 July 2016, para 1.

[151] 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' OJ C262, 19 July 2016, para 3, see also Claire Micheau, *State Aid, Subsidy and Tax Incentives Under EU and WTO Law* (Kluwer Law International 2014) 465.

[152] Except for Regulation (EU) No 492/2011 of the European Parliament and the Council of 5 April 2011 on freedom of movement for workers within the Union [2011] OJ L141, Art 7(2), which requires the equal tax treatment of national and foreign workers.

[153] International Bureau of Fiscal Documentation, 'The EEC Reports on Tax Harmonization: The Report of The Fiscal and Financial Committee and The Reports of The Sub-Groups A, B and C' (IBFD 1963) 101, cf Christiana Panayi, 'The Harmonization of Direct Taxes' in Alicia Hinarejos and Robert Schütze (eds), *EU Fiscal Federalism: Past, Present, Future* (OUP 2023) 82ff.

scales, regardless of the difference in tax rates.[154] It viewed tax harmonisation as a dynamic process and a long-term political matter that should be achieved in successive stages, and set out a timetable for implementation.[155] This plan was however not implemented, nor were the subsequent proposals. A few years later, the Commission published the Programme for the harmonisation of direct taxes, which proposed harmonisation measures relating, amongst others, to withholding taxes on dividends and interest, a uniform personal income tax and cross-border mergers.[156] In the 1970 Van den Tempel Report, Professor van den Tempel was asked by the Commission to examine the classical tax system, the tax credit system and the split-rate system in his evaluation of tax harmonisation measures. He concludes that the classical system of corporate taxation, in which a company is treated as a taxable entity separate from its shareholders, best meets the needs of the (then) Community.[157] The Commission's 1975 proposal for a directive on the approximation of tax rates between 45 and 55% called for a common imputation system of corporate tax and a common system of withholding tax on dividends, but it was ultimately rejected by the European Parliament.[158] Following this, the Commission pointed out the difficulties involved in designing a common tax policy and harmonising tax rates, and concluded that this would only be possible at a more advanced stage of economic integration.[159] Hence, it shifted its focus to completing the internal market.[160]

The Parent-Subsidiary Directive,[161] originally from 1990, aims at the elimination of tax obstacles relating to profit distributions between company groups by abolishing withholding taxes on dividend payments between associated companies and by avoiding double taxation of

[154] International Bureau of Fiscal Documentation, 'The EEC Reports on Tax Harmonization: The Report of The Fiscal and Financial Committee and The Reports of The Sub-Groups A, B and C' (IBFD 1963) 119; for the specific corporate tax rates proposed see 122ff and 139ff of the Report.
[155] International Bureau of Fiscal Documentation, 'The EEC Reports on Tax Harmonization: The Report of The Fiscal and Financial Committee and The Reports of The Sub-Groups A, B and C' (IBFD 1963) 152ff; the first stage focused on turnover taxes, the second stage on income taxes and the third stage on implementing all the proposed reforms.
[156] Commission, 'Tax harmonization programme' (Memorandum to the Council) Supplement to Bulletin No. 8-1967 of the European Economic Community, 8 February 1967.
[157] Arnold Jan van den Tempel, 'Corporation Tax and Individual Income Tax in the European Communities' (1970) Competition: Approximation of Legislation Series no 15.
[158] Commission, 'Proposal for a Council Directive concerning the harmonization of systems of company taxation and of withholding taxes on dividends' COM(75) 392 final; Christiana Panayi, *European Union Corporate Tax Law* (CUP 2013) 14ff.
[159] Commission, 'Report on the scope for convergence of tax systems in the Community' COM(80) 139 final, 27 March 1980, 5-8.
[160] Commission, 'Guidelines on company taxation' (Communication) SEC(90) 601 final, 20 April 1990, adopting the proposals of the Merger Directive, the Parent-Subsidiary Directive and the Arbitration Procedure Convention.
[161] Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (recast) [2011] OJ L345/8.

dividends in the hands of the parent company.[162] The Merger Directive[163] was also adopted in 1990 (later amended several times) and removes fiscal obstacles to cross-border reorganisations involving companies in more than one MS. In the case of mergers, divisions, transfer of assets or exchange of shares, it provides for a system of tax deferral (until the actual disposal of the asset or realisation of the profit) of capital gains at company and shareholder level.[164] The Interest and Royalties Directive,[165] which was proposed in 1991 but was only revised and adopted later, is designed to abolish withholding taxes on interest and royalty payments provided that the beneficial owner is a company or a permanent establishment in another MS.[166] Moreover, the Commission launched the Code of Conduct for Business Taxation in 1998.[167]

In the wake of the Commission's Action Plan for a fair and efficient corporate taxation,[168] the Commission relaunched its 2011 proposal on a Common Corporate Tax Base (CCTB) and a Common Consolidated Corporate Tax Base (CCCTB) in 2016. The proposed directives call for the establishment of common corporate tax rules as well as the implementation of a framework in which businesses can apply a single consolidated tax declaration for all of their operations to a single MS's tax authority using an apportionment formula.[169] In 2018, the Commission proposed another two directives concerning the taxation of digital business activities. The first directive, the preferred long-term solution, would introduce the taxation of profits allocated to a company based on its digital presence or virtual permanent establishment in a MS.[170] The second, interim proposal entails the introduction of a digital services tax.[171] In 2023, the Commission presented a new framework for business taxation. This includes considering the

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162 Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (recast) [2011] OJ L345/8, recitals 3-4.

163 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.

164 Commission, 'Merger Directive' (Taxation and Customs Union) <https://ec.europa.eu/taxation_customs/business/company-tax/merger-directive_en> accessed 17 September 2024.

165 Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States [2003] OJ L157/49.

166 Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States [2003] OJ L157/49, recital 4 and Art 1.

167 Council, 'Conclusions of the ECOFIN Council Meeting on 1 December 1997 concerning taxation policy' (Resolution) OJ C2

168 Commission, 'A Fair and Efficient Corporate Tax System in the European Union: 5 Key Areas for Action' (Communication) COM(2015) 302 final, 17 June 2015, which is an updated version of Commission, 'An Action Plan to strengthen the fight against tax fraud and tax evasion' (Communication) COM(2012) 722 final.

169 Commission, 'Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB)' COM(2016) 683 final.

170 Commission, 'Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence' COM(2018) 147 final.

171 Commission, 'Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services' COM(2018) 148 final.

withdrawal of its CCCTB proposal and replacing it with single corporate tax rulebook, which the Commission calls 'Business in Europe: Framework for Income Taxation (BEFIT)'.[172] BEFIT aims to make life easier for business and tax authorities by introducing a new, standardised set of rules for calculating the tax base of groups of companies. Accordingly, the tax base of all members of the group is to be summarised in a single tax base. The proposal and the package build on the OECD's international tax treaty on global minimum taxation and also contain a proposal to harmonise transfer pricing rules within the EU.[173] The proposals on transfer pricing[174] and on the head office tax system for small and medium-sized enterprises[175] are expected to enter into force in 2026.

In addition, the Commission presented a package of tax transparency measures in 2015. A central element of this package is the automatic exchange of information on tax rulings between MS.[176] There are several other directives dealing with the reinforcement of tax administration and automatic exchange of information, including the Directive on Administrative Cooperation (DAC)[177] and the Dispute Resolution Directive.[178] In line with the Commission's aim to combat tax avoidance, the Anti-Tax Avoidance Directives (ATAD I[179] and ATAD II[180]) were implemented in response to the OECD's BEPS project, forming part of the Anti-Tax Avoidance Package.[181] ATAD II complements ATAD I in that it adds rules on hybrid mismatches. In essence, the ATAD contains five anti-abuse measures to prevent aggressive tax planning by imposing greater transparency requirements on MNEs. First, the interest limitation rule restricts interest deduction to 30% of taxable earnings before interest, tax, depreciation and amortisation in order to make debt arrangements to minimise taxation more difficult. Second, the exit

[172] Commission, 'Business Taxation for the 21st Century' (Communication) COM(2021) 251 final; Commission, 'Proposal for a Council Directive on Business in Europe: Framework for Income Taxation (BEFIT)' COM(2023) 532 final.
[173] See also Commission, 'Taxation: new proposals to simplify tax rules and reduce compliance costs for cross-border businesses' (Press Release) IP/23/4405, 12 September 2023.
[174] Commission, 'Proposal for a Council Directive on transfer pricing' COM(2023) 529 final.
[175] Commission, 'Proposal for a Council Directive establishing a Head Office Tax System for micro, small and medium sized enterprises, and amending Directive 2011/16/EU' COM(2023) 528 final.
[176] See in particular Council Directive (EU) 2015/2376 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation [2015] OJ L332.
[177] Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC (DAC) [2011] OJ L64 (subject to subsequent amendments, DAC 2 to DAC 8).
[178] Council Directive (EU) 2017/1852 of 10 October 2017 on tax dispute resolution mechanisms in the European Union [2017] OJ L265.
[179] 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.
[180] Council Directive (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries [2017] OJ L144.
[181] Next to the ATAD, the Package is composed of the Communication on an External Strategy for Effective Taxation, the amendment to the Directive on administrative cooperation and the Recommendation on tax treaties.

taxation rules provide for a tax on the transfer of assets from a taxpayers' head office to its permanent establishment in another MS and vice versa when the MS no longer has the right to tax the transferred asset, in order to prevent companies from avoiding tax when relocating assets. Third, the controlled foreign company rules are designed to prevent profit shifting to a dependent company in a low-tax country in order to reduce taxable profit. If a company is treated as a controlled foreign company, the income of that company is taxed at the EU parent company. Fourth, the general anti-abuse rule requires MS to ignore arrangements that are put in place for the purpose of obtaining a tax advantage and that frustrate the aim of the applicable tax law if they are not genuine. Fifth, the hybrid mismatch rule seeks to prevent companies from exploiting mismatches to avoid taxation in cross-border mismatch situations, between associated companies or which result in deduction without inclusion or double deduction outcomes. Thereby, the directive aims to establish a minimum level of protection against tax avoidance by companies in the EU, while also aiming to ensure a fair and stable environment for businesses.[182] In 2021, the Commission published a draft directive on the abusive use of shell entities or letterbox companies domiciled in the EU (ATAD III or UNSHELL initiative).[183] In a similar vein, with its Fiscalis programme and regulation, the Commission aims to improve the proper functioning of the MS' tax systems by supporting participating countries in the fight against tax fraud, tax evasion and aggressive tax planning. It intends to facilitate the implementation of EU law in the field of taxation by ensuring exchange of information, supporting administrative cooperation and helping to reduce the administrative burden on tax authorities and compliance costs for taxpayers.[184]

Especially at the level of group companies, the aforementioned directives, regulations and proposals present an important pillar of direct harmonisation. The Commission indeed realises that current tax rules are not fit for the modern global and digitalised economy. However, most rules and arrangements on direct taxation and the taxation of cross-border income are not covered by written EU law, but by a wide network of bilateral tax treaties between MS. It should be noted that discussions at the OECD level continue in parallel. Since the members have agreed

[182] Commission, 'The Anti Tax Avoidance Directive' (Taxation and Customs Union) <https://ec.europa.eu/taxation_customs/business/company-tax/anti-tax-avoidance-package/anti-tax-avoidance-directive_en> accessed 17 September 2024.

[183] Commission, 'Proposal for a Council Directive laying down rules to prevent the misuse of shell entities for tax purposes and amending Directive 2011/16/EU' COM(2021) 565 final.

[184] Regulation (EU) 2021/847 of the European Parliament and of the Council establishing the 'Fiscalis' programme for cooperation in the field of taxation and repealing Regulation (EU) No 1286/2013 [2021] OJ L188/1; Commission, 'Cooperation in the field of taxation (FISCALIS)' (Commission EU funding programmes) <https://commission.europa.eu/funding-tenders/find-funding/eu-funding-programmes/cooperation-field-taxation-fiscalis_en> accessed 17 September 2024.

on the so-called two-pillar solution, which addresses the tax challenges of digitalisation, the Commission's proposals have been put on hold in the hope of finding a global solution. The subsequent adoption of the EU's Pillar Two Directive in 2022 introduces minimum tax rates and rules for multinational groups.[185] This will now be further explored.

2.6.3. OECD's BEPS Project and International Developments

Also on a more international agenda, States have focussed on the prevention of tax avoidance and shifting of the tax base. The debate on tax competition promoted by the BEPS project by the OECD has pushed forward the trend of a wider understanding of fiscal State aid. The OECD/G20[186] Inclusive Framework on BEPS involves over 135 countries and jurisdictions, which collaborate on the implementation of 15 measures (so-called Actions). The principal idea for this initiative was to strive for a transformation of international tax rules. In essence, the OECD has identified and addressed tax challenges emanating from the digital and globally integrated economy. Some of the principal reasons for intervention are the loss of revenue, higher compliance costs, the threat to the tax system's integrity, and the harm to fair competition.[187] The term 'base erosion' refers to a decrease in the number of enterprises and the amount of profits burdened in a country. Intellectual property transfer and royalty payments are often the key factor. The phenomenon of profit shifting involves aggressive tax planning and the relocation to low tax countries in order to avoid paying high tax rates or none at all.[188] It is precisely at this point that the BEPS project wishes to make a change: the measures are intended to "ensure that profits are taxed where economic activities take place and value is created".[189] The OECD proposes a two-pillar solution to address the tax challenges arising from the digitalisation of the economy. The first pillar proposes a redistribution of international taxing rights and, in parallel (or alternatively), the introduction of a global minimum taxation (pillar 2).[190]

[185] 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 [2022] OJ L328/1.

[186] The G20 or Group of Twenty is an international forum consisting of 19 countries and the EU representing the most important industrialised and emerging countries.

[187] OECD, 'Action Plan on Base Erosion and Profit Shifting' (OECD Publishing 2013) 8 <https://www.oecd.org/en/publications/action-plan-on-base-erosion-and-profit-shifting_9789264202719-en.html> accessed 17 September 2024.

[188] Angharad Miller and Lynne Oats, *Principles of International Taxation* (4th edn, Bloomsbury 2014) 545; Swapneshwar Goutam, 'Critical account of the OECD's Action Plan on Base Erosion and Profit Shifting' (2014) 8 Madras Law Journal 287, 288.

[189] OECD, 'Explanatory Statement: OECD/G20 BEPS 2015 Final Reports' (OECD 2015) para 1 <https://www.oecd-ilibrary.org/taxation/beps-project-explanatory-statement_9789264263437-en> accessed 17 September 2024.

[190] OECD, 'Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy' (OECD 2021) <https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf> accessed 17 September 2024.

The Commission's Action Plan of 2012, updated in 2016, is largely inspired by the BEPS project.[191] The EU has also adopted a directive to implement global minimum taxation.[192] These initiatives show that progress was and is still made to fight tax fraud and evasion and to align tax laws, but does not lead to the disappearance of tax competition and incentives. In the EU, actions to introduce changes regularly fail due to the unanimity needed of all finance ministers in direct tax matters. As will be seen throughout the chapters, the EU goes even further than the OECD and increasingly strives for direct tax harmonisation via the State aid rules.

This pressing ahead by the Commission and the OECD has led United States (US) American politicians and practitioners to continuously express concerns that its investigations and the BEPS project unfairly focus on US MNEs.[193] The lack of transparency concerning the selection criteria and methodology according to which the Commission picks its State aid cases is a thorn in the side of US authorities. Although the US is a member country to the OECD,[194] it has never signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS due to an allegedly low degree of exposure to BEPS issues and the conviction of an already existing observance of the principles contained therein.[195] Many MNEs have received tailwind from then US President Donald Trump's tax reform, benefiting US corporations since the beginning of 2018 under the Tax Cut and Jobs Act (TCJA).[196] As explained by the Internal Revenue Service, the law allows accelerated depreciation, i.e. in some cases investments can be completely offset already in the first year.[197] Thus, what initially looks like a postponement is in reality an interest-free loan at government expense. In addition, under the Global Intangible Low Tax Income (GILTI) provision, if a company generates untaxed profits in a tax haven, it will be liable to have that profit taxed as though it arose in the US. However, the effective tax rate that will apply is half the tax rate of 21%, or 10.5%. Further, if a company reports a loss in

[191] See eg Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States [2011] OJ L345/8.
[192] 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 [2022] OJ L328/1.
[193] See eg Christian Oliver and Jim Brunsden, 'US blasts Brussels over tax probe bias' (Financial Times, 30 January 2016) <https://www.ft.com/content/c63db5c8-c6b1-11e5-808f-8231cd71622e> accessed 17 September 2024.
[194] OECD, 'Member Countries' (OECD) <https://www.oecd.org/en/about/members-partners.html> accessed 17 September 2024.
[195] OECD, 'Signatories and parties to the Multilateral Convention to implement tax treaty related measures to prevent base erosion and profit shifting' (OECD, status 13 September 2024) <https://www.oecd.org/content/dam/oecd/en/topics/policy-sub-issues/beps-mli/beps-mli-signatories-and-parties.pdf> accessed 17 September 2024.
[196] See eg Public Law 115-97 of 22 December 2017 Tax Cut and Jobs Act, 131 STAT. 2208, Subtitle C pt 1, sec 13001, which includes a reduction in corporate tax from 35% to 21%.
[197] Internal Revenue Service, 'New rules and limitations for depreciation and expensing under the Tax Cuts and Jobs Act' (IRS, 9 April 2019) <https://www.irs.gov/newsroom/new-rules-and-limitations-for-depreciation-and-expensing-under-the-tax-cuts-and-jobs-act> accessed 17 September 2024.

the US, this can be set against the GILTI provision or deemed US income.[198] This further reduces tax liability. In turn, US President Joe Biden has proposed to increase the corporate income tax from 21% to 28%.[199] Furthermore, the then US Secretary of Treasury has expressed her commitment to the cooperative multilateral effort by the OECD to address BEPS and to resolve taxation disputes in the future.[200] Most interestingly, at the Group of Seven (G7) summit in June 2021 and after the OECD Inclusive Framework explored such a possibility, an accord could be reached on the creation of a global minimum corporate tax rate of at least 15% (Pillar 2).[201] This was very much welcomed by EU Economy Commissioner Paolo Gentiloni.[202] Thereupon, as mentioned, the EU adopted the Minimum Corporate Taxation Directive to ensure a global minimum tax rate (15%) for multinational and large domestic groups in the EU whose annual turnover exceeds EUR 750 million and which have either a parent company or a subsidiary in an EU MS.[203] The future will show whether the OECD/G20 meetings will reach a broader consensus in this area.

2.7. Interim Conclusion on the Normative Framework

On a legal, economic, and political level, the control of State incentives is becoming increasingly important in a globalised and digitalised world. In order to safeguard the well-functioning of the internal market and free competition, State aid rules serve as an important protective mechanism. Their logic lies in the voluntary commitment by MS to refrain from exerting undue influence on trade and to avoid anti-competitive damaging practices. Fiscal State aid can have both negative and positive effects. One of the main negative impacts is the encouragement of aggressive tax competition between MS to attract the most lucrative

[198] Public Law 115-97 of 22 December 2017 Tax Cut and Jobs Act, 131 STAT. 2208, Subpart B ch 1; for a different view see also Reuven Avi-Yonah, 'A Positive Dialectic: BEPS and the United States' (2020) 114 American Journal of International Law Unbound 255.

[199] Joe Biden, 'The Biden-Harris Plan to Fight for Workers by Delivering on Buy America and Make it in America' (Biden Harris Democrats) <https://joebiden.com/wp-content/uploads/2020/09/Buy-America-fact-sheet.pdf> accessed 17 September 2024.

[200] US Senate Committee on Finance, 'Hearing on the nomination of Dr. Janet Yellen' (Finance Committee of Senate, 21 January 2021) <https://www.finance.senate.gov/imo/media/doc/Dr%20Janet%20Yellen%20Senate%20Finance%20Committee%20QFRs%2001%2021%202021.pdf> accessed 17 September 2024; for more see Assaf Harpaz, 'Taxation of the Digital Economy: Adapting a Twentieth-Century Tax System to a Twenty-First-Century Economy' (2021) 46 Yale Journal of International Law 57.

[201] Leigh Thomas and David Lawder, 'Explainer: What is a global minimum tax and what will it mean?' (Reuters, 7 June 2021) <https://www.reuters.com/business/finance/what-is-global-minimum-tax-what-will-it-mean-2021-06-05/> accessed 17 September 2024; Deutsche Welle, 'G7 agrees 'historic' global minimum corporate tax rate' (DW, 5 June 2021) <https://www.dw.com/en/g7-agrees-historic-global-minimum-corporate-tax-rate/a-57786417> accessed 17 September 2024.

[202] See eg Commission, 'Remarks by Commissioner Gentiloni at the press conference on the Communication on Business Taxation 21' (Speech, 18 May 2021) <https://ec.europa.eu/commission/presscorner/detail/en/SPEECH_21_2547> accessed 17 September 2024.

[203] Council Directive (EU) 2022/2523 of 15 December 2022 on ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups in the Union [2022] OJ L328/1, 9.

investments and become the country of establishment of choice. Incidents, such as the LuxLeaks scandal of 2014 further evidence this phenomenon, whereby investigative journalists uncovered a system of favourable tax rulings.[204] Only recently, investigative journalists of ProPublica have started an ongoing reporting project called 'the secret IRS files' revealing how the wealthiest and their companies avoid income tax (e.g. Amazon founder Jeff Bezos and Tesla founder Elon Musk).[205] Hence, to safeguard the single market and the fundamental freedoms, the Commission was assigned the responsibility for State aid control under the Treaties. Lately, the Commission made use of its powers to europeanise national direct tax laws and to step in whenever the smallest tax policy gaps allow so. By a strategic use of the State aid rules, the Commission promotes further tax integration.

The application of State aid law to tax legislation (as opposed to individual tax rulings) presents a great challenge: MS are free to decide which economic events and behaviour will be taxed.[206] Consensus among the MS is not easily achieved when it comes to the alignment of tax laws. This is best demonstrated by the slow and unsuccessful attempts to finalise the CCCTB, the scarce existence of directives or the unanimity requirement for direct tax matters. Due to the fact that direct taxation still remains an exclusive MS competence, EU institutions have little leeway for further harmonisation other than through case law. It can be discerned from the above that there is a conflict between, on the one side, a broad definition and interpretation of State aid in order to prevent market and competition distortions as effectively as possible and, on the other side, the MS' ability to pursue their own fiscal policies, which is still an exclusive competence. The lack of positive integration implies disparities but also opportunities to be explored by the EU legislator and enforcer. Therefore, negative integration is an important tool for both sets of rules in the area of direct taxes.

The EU is not a fiscal union and lacks a uniform codified tax law due to the lack of a comprehensive authorisation basis for harmonisation. Accordingly, a frequently repeated formulation of the CJEU is that "although […] direct taxation does not as such fall within the purview of [EU], the powers retained by the Member States must nevertheless be exercised

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[204] For more see International Consortium of Investigative Journalists, 'About this Project: Luxembourg Leaks' (ICIJ, 5 November 2014) <https://www.icij.org/investigations/luxembourg-leaks/about-project-luxembourg-leaks/> accessed 17 September 2024.

[205] For more see Jesse Eisinger, Jeff Ernsthausen and Paul Kiel, 'The Secret IRS Files: Trove of Never-Before-Seen Records Reveal How the Wealthiest Avoid Income Tax' (ProPublica, 8 June 2021) <https://www.propublica.org/article/the-secret-irs-files-trove-of-never-before-seen-records-reveal-how-the-wealthiest-avoid-income-tax> accessed 17 September 2024.

[206] Wolfgang Schön, 'Tax Legislation and the Notion of Fiscal Aid: A Review of 5 Years of European Jurisprudence' in Isabelle Richelle, Wolfgang Schön and Edoardo Traversa (eds), *State Aid Law and Business Taxation* (Springer 2016) 5.

consistently with [EU] law".[207] Thus, despite the MS' tax sovereignty, EU principles, fundamental freedoms and State aid rules must be observed. Both sets of rules follow the standards and rules of non-discrimination, non-restriction and non-distortion in accordance with the ideal of a European free market economy. These similarities will be further explored in Chapter 5. Although the State aid rules and the fundamental freedoms pursue similar objectives, they differ in scope: The fundamental freedoms are only triggered in cross-border situations, whereas the prohibition of State aid is broader and applies to purely domestic situations. Moreover, State aid law focuses on positive discrimination, i.e. advantaging only certain undertakings, whereas the fundamental freedoms prohibit negative discrimination, i.e. disadvantaging transnational operations.[208] Additionally, the fundamental movement rights are also granted to individuals, and not only undertakings. While it is true that fiscal obstacles to the internal market have been removed via the free movement rights, the control of State incentives in the form of taxation remains incomplete.

Notwithstanding the political momentum created by the global agreement on corporate minimum taxation, it should be kept in mind that the introduction of a minimum corporate tax rate in the EU significantly limits the tax sovereignty of MS and has been met with resistance for decades. Given the fate of previous proposals involving some form of tax rate harmonisation, the adoption of this directive is a breakthrough. It could pave the way for further corporate tax harmonisation in the EU. This is only possible and feasible if the Commission takes a more long-term and strategic view, rather than relying on current political events. Moreover, it is time to think not only about corporate taxation, but also about tax issues affecting EU citizens. The current EU legislation on direct taxation is a patchwork of minimum rules applicable to companies and relies on the extensive case law of the CJEU. However, de facto harmonisation through the case law of the CJEU causes administrative difficulties for MS and their authorities due to the retroactive effect of the decisions and offers taxpayers little legal certainty. The decisions often intervene deeply in the tax system and do not seem suitable to compensate for the lack of normative harmonisation. One of the reasons for this is that these are selective individual decisions that often only affect one MS and, again, apply retroactively. The fact that the provisions of Union law require interpretation is already evident from the large number of questions referred.

[207] Eg Case C-279/93 *Schumacker* [1995] ECR I-225, para 21.
[208] Peter Wattel, 'State Aid, Free Movement, Harmful Tax Competition and Disparities' in Isabelle Richelle, Wolfgang Schön and Edoardo Traversa (eds), *State Aid Law and Business Taxation* (Springer 2016) 60.

Correspondingly, the CJEU has progressively developed its own method of assessment via Art 107(1) TFEU. In particular, the three-step analysis and the focus on the selectivity criterion have become most crucial in its interpretation. The selectivity test under Art 107 TFEU will be further analysed in the next chapter. The weaknesses of this test are then compared with those of the non-discrimination test under the fundamental freedoms, so that a way can ultimately be found to optimise such a test for fiscal State aid. Ideally, such a test would then also be incorporated into a Commission proposal to further enhance legal certainty and to advance the introduction of EU legislation on direct taxation.

3. Unravelling the Criterion of Material Selectivity by Exploring Inconsistencies and Shortcomings in Fiscal State Aid Law

National tax measures are not shielded from EU State aid control. As discussed in Chapter 2.1., the tax sovereignty of MS is not absolute and must be exercised in accordance with EU law and principles, including State aid law.[209]

Fiscal State aid can take different forms: It can be abstract aid granted through legislation, such as tax schemes benefiting an undefined number of taxpayers, which meet certain objective conditions and specific characteristics.[210] Aid schemes are intrinsic rules of a tax system, which are in principle accessible to anyone meeting the criteria, but in fact favouring only certain groups or categories of undertakings. Moreover, fiscal aid may also be granted via targeted measures addressing taxpayers individually, such as tax rulings or advance pricing agreements (APAs). Tax rulings as such are not prohibited and indeed provide for legal certainty and clarity as to how domestic tax rules and methods are applied to given circumstances. However, tax administrations may also assess the tax obligations in a more favourable way for individual businesses or categories resulting in a tax base reduction (e.g. accelerated depreciation) or in a tax rate reduction (e.g. tax exemption or credit). Over the past years, the Commission has shifted its particular attention from general to targeted fiscal State aid measures. Additionally, tax administrations may decide not to collect tax debts resulting in tax deferral, cancellation or the rescheduling of tax debts.[211] It should be borne in mind that the notion of tax may further encompass capital duties, social security contributions, as well as royalties.[212] What also falls under the control of State aid are parafiscal charges, i.e. compulsory payments for specific purposes that are usually managed separately from the general State budget (e.g. environment protection fees). In this case, the modalities of the use of the revenues are the focus of the State aid assessment.[213] It is thus immaterial whether a measure is a tax in the strict sense, a fee, a premium, a parafiscal levy or similar and how it is officially labelled. In general, tax measures

[209] Case C-279/93 *Schumacker* [1995] ECR I-225, para 21.
[210] See also Thomas Jaeger, *Beihilfen durch Steuern und parafiskalische Abgaben* (NWV 2006) paras 140ff.
[211] Joined Cases T-92/00 and T-103/00 *Diputación Foral de Álava v Commission* [2002] ECR II-1385 para 31; Oyabradoh Enodeh, 'The notion of (fiscal) State aid: decisions of the EU Commission and case law of the EU courts' (Tilburg University 2018) 2.
[212] Claire Micheau, 'State aid and taxation in EU law' in Erika Szyszczak (ed), *Research Handbook on European State Aid Law* (Edward Elgar 2011) 197-198.
[213] Thomas Jaeger, 'Part VII Tax Measures' in Franz Jürgen Säcker and Frank Montag (eds), *European State Aid Law: A Commentary* (Beck/Hart 2017) paras 15-17.

are easily imputable to the State, since the collection of taxes and any benefits granted are based on laws or regulations and are enforced by the administration.[214]

Tax norms usually distinguish between tax immanent, logical purposes, such as equality and fairness aspects (e.g. progressive taxation, ability to pay), economic aspects (consumption tax) or behavioural control (environmental tax, polluter-pays principle). Only those tax concessions that are designed to strengthen certain undertakings or sectors are State aid relevant. One of the major difficulties of State aid law is to differentiate general tax measures from those that are selective, since taxes by their very nature cause different burdens and levels of taxation.[215]

The most critical and ambiguous condition in the intricate landscape of the fiscal State aid analysis under Art 107(1) TFEU is selectivity.[216] The selectivity criterion is reproduced in the wording "favouring certain undertakings or the production of certain goods". Rooted in the principle of fair competition, its *raison d'être* is to serve as yardstick distinguishing between national measures that may distort the internal market by discriminately favouring only certain undertakings and sectors falling under the State aid regime and those of general nature applying to all undertakings and sectors alike.[217] Selectivity occurs in different forms: it can be sectoral, structural, behavioural, geographical, de facto etc. The notion of selectivity has always been interpreted very broadly and generously by the CJEU: whenever national authorities are granted a margin of discretion and they do exercise it, the national tax scheme or measure will be considered selective.[218] Moreover, tax schemes will also be selective if the advantage is made

[214] Thomas Jaeger, 'Part VII Tax Measures' in Franz Jürgen Säcker and Frank Montag (eds), *European State Aid Law: A Commentary* (Beck/Hart 2017) paras 3 and 19.
[215] Thomas Jaeger, 'Part VII Tax Measures' in Franz Jürgen Säcker and Frank Montag (eds), *European State Aid Law: A Commentary* (Beck/Hart 2017) paras 4ff.
[216] See eg Case C-88/03 *Portugal v Commission* [2006] ECR I-7115, para 54, where the ECJ considers selectivity as a constituent factor in the concept of State aid; Thomas Jaeger, *Beihilfen durch Steuern und parafiskalische Abgaben* (NWV 2006) paras 247ff.
[217] Nicola Pesaresi and Marc Van Hoof, 'State Aid Control: An Introduction' in Wolfgang Mederer, Nicola Pesaresi and Marc Van Hoof (eds), *EU Competition Law. Volume IV. State Aid, Book One* (Claeys & Casteels 2008) 7; Christoph Arhold, 'Part II Article 107' in Franz Jürgen Säcker and Frank Montag (eds), *European State Aid Law: A Commentary* (Beck/Hart 2017) 175 and 188.
[218] See eg Case C-200/97 *Ecotrade v Altiforni e Ferriere di Servola* [1998] ECR I-7907, paras 39-41; Joined Cases T-127/99, T-129/99 and T-148/99 *Diputación Foral de Álava and Others v Commission* [2002] ECR II-1275, paras 149ff; Joined Cases T-92/00 and T-103/00 *Diputación Foral de Álava v Commission* [2002] ECR II-1385, paras 31ff.

subject to specific criteria relating, amongst others, to the size of companies,[219] specific sectors or professions,[220] or financial prerequisites.[221]

In EU State aid law, selectivity and the principle of non-discrimination are interlinked: Selectivity is a key element in assessing whether a State measure constitutes State aid and refers to the granting of an advantage to certain companies that distinguishes them from others in a similar legal and factual situation. The three-step test is the method for determining selective treatment. It comprises the identification of a reference system, a deviation from it and a justification analysis. The principle of non-discrimination requires that State measures must be applied uniformly and without unjustified discrimination to all companies. This is to ensure that the measures do not unjustifiably favour certain companies over others. This concept is therefore closely linked to the concept of selectivity, as selective advantages often result from discriminatory treatment. Art 107 TFEU does not explicitly contain a non-discrimination standard in its definition. However, it is often taken into account when assessing the second step of the three-step test and can be considered inherent to it.[222] The concepts, therefore, work together.

In a number of cases, the detection of selectivity is not straightforward. Difficulties predominantly arise when a system or measure is at stake, which is prima facie open to all or a large number of undertakings, or which determines its beneficiaries according to complex criteria. In those cases, the starting point of the analysis, the application of the three-step test, is difficult to establish. In particular, identifying a reference system and a possible derogation from this 'normal' rule is not an easy task. This exercise is even more onerous when adhering to the comparability analysis carried out by the CJEU. It is undisputed that determining whether a tax measure is selective often requires a complex legal and economic analysis. The

[219] See eg Case C-200/97 *Ecotrade v Altiforni e Ferriere di Servola* [1998] ECR I-7907 (large company); T-55/99 *CETM v Commission* [2000] ECR II-3207, paras 40ff (SME).
[220] See eg Case C-75/97 *Belgium v Commission* (Maribel) [1999] ECR I-3671, paras 29-31 (certain sectors of the processing industry only); Case C-143/99 *Adria-Wien Pipeline* [2001] ECR I-8365, para 52 (only manufacturers, as opposed to service providers).
[221] See eg Joined Cases T-92/00 and T-103/00 *Diputación Foral de Álava v Commission* [2002] ECR II-1385, paras 49ff (investment of a minimum of ESP 80 million).
[222] For a similar opinion, see eg José Luis Buendía, 'Quo Vadis Compatibility?' in Juan Jorge Piernas López, Leigh Hancher and Luca Rubini (eds), *The Future of EU State Aid Law* (EU Law Live Press 2023) 66; Thomas Jaeger, 'Steuerliche Maßnahmen' in Franz Jürgen Säcker, Ulrich Karpenstein and Markus Ludwigs (eds), *Münchener Kommentar zum Wettbewerbsrecht Band 5: Beihilfenrecht* (4th edn, Beck 2022) para 15; for a contrary opinion, see eg Wolfgang Schön, 'State Aid in the Area of Taxation' in Leigh Hancher, Tom Ottervanger and Piet Jan Slot (eds), *EU State Aids* (6th edn, Sweet & Maxwell 2021) paras 37-39; Andreas Bartosch, 'Fiscal Aid: Recent Trends and Relationship to Fundamental Freedoms' in Werner Haslehner, Georg Kofler and Alexander Rust (eds), *EU Tax Law and Policy in the 21st Century* (Kluwer Law International 2017) 87-88; Wolfgang Schön, 'Tax Legislation and the Notion of Fiscal Aid: A Review of 5 Years of European Jurisprudence' in Isabelle Richelle, Wolfgang Schön and Edoardo Traversa (eds), *State Aid Law and Business Taxation* (Springer 2016) 11-13.

Commission and the courts have the difficult task of assessing whether a measure treats similarly situated taxpayers differently in a way that unduly favours certain businesses. This analysis can be subjective and vary depending on the particular circumstances of each case, leading to uncertainty and controversy. The complexity of national tax systems with their different exemptions, deductions and special provisions, which can potentially confer selective advantages, adds to the uncertainty surrounding the selectivity criterion and its application. It is precisely for these reasons that it is so important that both the Commission and the CJEU adhere to coherent standards when discussing the selectivity of a measure. However, as will be demonstrated in the following subchapters, the selectivity assessment carried out by the Court refers to an incoherent set of benchmarks. Moreover, the GC and the ECJ can only rarely agree on the same method. The GC usually opts for a propulsive, narrow approach, whereas the ECJ often overrules the GC and adheres to a broad interpretation. This incoherence and broad interpretation of selectivity is criticised in several AG opinions. Former AG Geelhoed[223] and former AG Poiares Maduro,[224] for example, emphasised the danger of depriving MS of important economic policy instruments (and thus of competences reserved to them) and excessively scrutinising MS' decisions for the attainment of general policy objectives. Thus, selectivity divides not only companies but also the EU institutions.

In order to get to the bottom of the weaknesses of the selectivity test and to reduce or eliminate them, it is important to first analyse the development of case law: What do the individual test steps look like? How are they applied? What needs to be considered? This should show where or what the weak points of the test are. In a later step, it will then be discussed whether these can be remedied, in particular with regard to the methodology of the fundamental freedoms. This is done against the background that it is recognisable that the methodology of the selectivity analysis, in particular the second step of the test, has certain overlaps with the non-discrimination test of the fundamental freedoms or adopts them as its own. The current inconsistent approach is intended to show that the test needs to be adapted in order to be coherent and legally compliant. The non-discrimination standard is therefore a start.

Hence, this chapter attempts to unravel the intricacies of the (material) selectivity test, scrutinise its coherence and highlight its shortcomings. Through a review of CJEU case law, it attempts to shed light on the challenges associated with this criterion in order to ultimately provide a clearer and more robust framework for the assessment of State aid cases in the area of direct

[223] Case C-308/01 *GIL Insurance and Others* [2004] ECR I-47777, Opinion of AG Geelhoed, para 76.
[224] Case C-237/04 *Enirisorse* [2006] ECR I-2843, Opinion of AG Poiares Maduro, paras 45-46.

taxes. The following subchapters present the development of the selectivity criterion and its application in practice, as handled by the Commission and the CJEU. It should be noted in advance that a separate chapter is devoted to tax rulings, as these are a special form of tax measure which have gained particular importance for fiscal State aid law in recent years.

The various cases discussed in this chapter illustrate the specific legal issues of each subchapter. The selected judgements shaped and established legal principles and were therefore chosen based on factors such as the novelty of the legal issues, the impact on subsequent case law or their relevance to current debates and developments. They aim to present a diverse range of perspectives, approaches and outcomes in relation to the different levels of selectivity. The selection of cases is based on certain methodological aspects, namely thematic relevance and in chronological order. It is simply not possible to provide an overview of all cases in this area due to space constraints. Further explanations can often be found in the footnotes. Hence, this overview aims to provide a balanced presentation of the relevant cases and perspectives.

The chapter is organised as follows: At the beginning, the criterion of selectivity and its components are briefly discussed for orientation, but the focus of this chapter is on material selectivity. Subsequently, the methodology is explained. This consists of the three-step test. The three steps are each analysed individually and explained on the basis of the relevant case law. The judgements are divided into thematic categories and treated chronologically, building on each other. As the category of tax rulings is particularly significant and topical, it is dealt with separately. This is intended to give a uniform overall impression of the subject matter, as it involves more specific considerations. In addition, these judgements are the most recent in relation to the selectivity analysis and therefore conclusively describe the current status.

3.1. Geographical v Material Selectivity (and Administrative Practice)

Selectivity is made up of two components, a geographical (or regional or territorial) and a material one. Material and geographical selectivity are not cumulative and can therefore exist independently of each other.[225]

Certain tax measures may apply only to certain regions and may differ from the rules applicable under the general national system. The geographical element foresees that a measure is selective if companies in a specific part of a MS' territory receive preferential treatment over other

[225] 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' OJ C262, 19 July 2016, para 119.

operators in the remainder of the country.[226] The underlying reason for such State intervention is regional development by attracting investments to a designated area.[227] The Court ruled that a system of regional autonomous taxation constitutes a separate reference system and is not to be considered a derogation from a national standard.[228] Consequently, a geographically selective measure may escape the qualification as State aid if it fulfils three cumulative conditions: First of all, the given province or region must have a certain fiscal autonomy, i.e. a separate political and legal status from the central government. Second, the authority must have procedural autonomy and must be independent from other intervention regarding the measure. Last, the authority must enjoy financial autonomy and thus be able to face any financial consequences of the introduction of a measure.[229] Hence, the term 'State' in Art 107(1) TFEU must be understood in the broad sense.[230] Regional selectivity usually does not pose a problem, since a measure which is not applied to the whole territory of a MS is in principle deemed to be selective.[231]

Material selectivity, *au contraire*, embraces all other forms of State intervention leading to the unequal treatment of businesses. It can be established in law or in fact:[232] On the one hand, de jure selectivity results from the legal criteria itself, rendering measures accessible only to certain undertakings. On the other hand, de facto selectivity results not directly from the rule itself but from its actual effects. At first glance, de facto selective measures apply objectively to all, but in fact they only benefit certain undertakings or sectors.[233] In practice, factual selectivity is common for fiscal State aid, since tax regimes may be framed in general terms, but advantaging only certain undertakings. A prime example of such a situation is the *Gibraltar* case, which will

[226] See eg Case C-88/03 *Portugal v Commission* [2006] ECR I-7115; Joined Cases C-428/06 to C-434/06 *UGT-Rioja* [2008] ECR I-6747; Case T-75/03 *Banco Comercial dos Açores v Commission* [2009] ECR II-143.
[227] See eg Case C-110/03 *Belgium v Commission* [2005] ECR I-2801, para 58.
[228] Case C-88/03 *Portugal v Commission* [2006] ECR I-7115, paras 57 and 58.
[229] Case C-88/03 *Portugal v Commission* [2006] ECR I-7115, paras 54-56 and 64; Joined Cases C-428/06 to C-434/06 *UGT-Rioja* [2008] ECR I-6747, paras 86-87 (institutional autonomy), 95-110 (procedural autonomy) and 123-135 (economic and financial autonomy).
[230] See eg Case C-248/84 *Germany v Commission* [1987] ECR 4013, paras 17-18; 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' OJ C262, 19 July 2016, para 5.3.
[231] 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' OJ C262, 19 July 2016, para 142; for more on geographical selectivity see Christoph Arhold, 'Part II Article 107' in Franz Jürgen Säcker and Frank Montag (eds), *European State Aid Law: A Commentary* (Beck/Hart 2017) paras 415ff; Saturnina Moreno González, 'Taxation and Limits to State Aid: the Case Law of the CJEU on Regional Selectivity and Its Application by Spanish Courts' (2017) EStAL 340.
[232] 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' OJ C262, 19 July 2016, para 121.
[233] Leo Flynn, *EU Competition Law, Volume 4: State Aid* (Claeys & Casteels 2016) 268ff.

be discussed in more detail below. Thus, national tax laws do not have to be explicitly selective in order to fulfil the criterion of selectivity.

A particular form of material selectivity is that resulting from discretionary administrative practice. In this case, undertakings that are in principle entitled to certain measures and meeting the necessary criteria are not automatically granted the measure. Instead, the authority favours a particular undertaking. This is especially true if the eligibility criteria are vague or formulated in very general terms, leaving the administration a margin of discretion in its assessment, or if the authority sets these criteria itself. Where the administration based its decision on objective, non-discriminatory, pre-determined and appealable criteria, the measure will not be considered selective.[234]

The new dimension of the material (factual) selectivity was brought about by the *Gibraltar* decision. In this case, the CJEU had to rule on whether the design of the corporate tax system by Gibraltar conferred a selective advantage to offshore companies. The ECJ considered the system as being factually selective and sided with the Commission, rather than with the GC[235] who proposed a narrow and strict application of selectivity. Indeed, the ECJ held that

> "it is apparent that the regime at issue, by combining those bases, even if they are founded on criteria that are in themselves of a general nature, in practice discriminates between companies which are in a comparable situation with regard to the objective of the proposed tax reform […]. Combining those bases of assessment […] results in taxation according to the number of employees and the size of the business premises occupied, but also, due to the absence of other bases of assessment, excludes from the outset any taxation of offshore companies, since they have no employees and also do not occupy business property."[236]

The Court broadened the assessment criteria and applied its effects-doctrine, which consists in looking at the effects of a measure rather than at its causes or objectives, i.e. substance over form. Thus, in accordance with the Commission's position and against the AG's opinion, the ECJ pointed out that the proposed tax reform resulted in a different tax burden between offshore and onshore companies, presenting a discrimination. In *World Duty Free Group*, the ECJ

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[234] 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' OJ C262, 19 July 2016, paras 123-125.
[235] Joined Cases T-211/04 and T-215/04 *Government of Gibraltar and United Kingdom v Commission* [2008] ECR II-3745.
[236] Joined Cases C-106/09 P and C-107/09 P *Commission and Spain v Government of Gibraltar and United Kingdom* [2011] ECR I-11113, paras 101ff.

explicitly recognised the existence of de facto selectivity and thus also the existence of a de facto discrimination against undertakings in a comparable situation.[237] Nevertheless, the mere fact that some operators benefit more than others, does not necessarily and in every case mean that a tax measure is selective. Obviously, the concept of material factual selectivity is a complex one and will be further illustrated below by referring to and presenting the Court's most relevant case law.

3.2. The Three-Step Test – Derogation Approach

The Court was already confronted in 1969 with the distinction between general and selective tax measures and the need to reconcile national autonomy in fiscal matters with the prohibition of competition-distorting State aid. It had to assess whether or not the national measure in question could be regarded as favouring domestic production.[238] The three-step framework emerged and was crystallised by important rulings of the Court.

In *Commission v France*, the Court considered that the measure, a preferential rediscount rate for exports, constituted aid despite the fact that it applied to all exported products. Those companies exclusively producing for the domestic market could not benefit from the advantage.[239] In subsequent cases, the Court followed a similar approach.[240] Some years later, in *Italy v Commission*, the Court laid the basis for the three-step test by concluding

> "that the partial reduction of social charges pertaining to family allowances devolving upon employers in the textile sector is a measure intended partially to exempt undertakings of a particular industrial sector from the financial charges arising from the normal application of the general social security system, without there being any justification for this exemption on the basis of the nature or general scheme of this system."[241]

Hence, a three-step approach is adopted in order to establish the existence of selectivity: (1) definition of the reference/normal system, (2) identification of a derogation/exemption from this system, (3) assessment of possible justifications. Essentially, the test involves identifying a derogation from the standard application of a tax measure. A comparison is made between

[237] Joined Cases C-20/15 P and C-21/15 P *Commission v World Duty Free Group, Banco Santander and Santusa* [2016] ECLI:EU:C:2016:981, paras 71ff.
[238] Joined Cases C-6/69 and C-11/69 *Commission v France* [1969] ECR 523; Case C-173/73 *Italy v Commission* [1974] ECR 709.
[239] Joined Cases C-6/69 and C-11/69 *Commission v France* [1969] ECR 523, paras 20-21.
[240] See eg Case C-57/86 *Greece v Commission* [1988] ECR 2855, paras 3 and 8; Case C-501/00 *Spain v Commission* [2004] ECR I-6717, paras 11 and 92.
[241] Case C-173/73 *Italy v Commission* [1974] ECR 709, para 15.

the tax treatment under the general, normal system and that under the derogatory measure. If the comparison results in the finding of a difference in treatment, the measure can be regarded as a derogation from the general system, unless the logic of the system justifies such selectivity.[242] The test basically assumes that a measure is considered general if it aims at achieving equality between economic operators. Thus, it reflects the principle of equal treatment and therefore a comparative reasoning. A derogation is equated with the application of different treatments in comparable situations. The Commission codified the three-step test and adopted the exception (derogation) criterion and the notion of common regime or reference framework corresponding to normal taxation in its 1998 State Aid Notice[243] and later in its updated version, the 2016 State Aid Notice.[244]

The three-step test was further developed and refined by the Court over the years. In *Adria-Wien Pipeline*, the Court further clarified the concept of selectivity, stating that a measure is selective where it favours certain undertakings over others which are in a comparable legal and factual situation in the light of the objective pursued by the measure.[245] The case concerned Austrian companies involved in the construction and operation of oil pipelines. The law in question concerned energy tax rebates that were available only to producers of goods and not to service suppliers. The ECJ ruled that the Austrian tax rebate scheme constituted selective State aid because it provided an unjustifiable selective advantage by favouring companies that produce goods over those that provide services.[246] The judgement emphasised that measures must not discriminate between companies in comparable situations, unless objectively justified.

In *Paint Graphos*, it became even clearer that the aim of selectivity is to find a material discrimination between similar situations and not just a formal exception to a rule.[247] The cases concerned Italian cooperatives, which, under Italian law, benefited from tax exemptions. The legislation granted cooperatives a preferential tax regime based on their mutualistic nature (e.g. the surplus was not distributed to members but reinvested in the cooperative). Paint Graphos and other cooperatives challenged the tax authorities' refusal to grant these benefits. The

[242] Claire Micheau, *State Aid, Subsidy and Tax Incentives Under EU and WTO Law* (Kluwer Law International 2014) 229-232; Claire Micheau, 'State aid and taxation in EU law' in Erika Szyszczak (ed), *Research Handbook on European State Aid Law* (Edward Elgar 2011) 202.
[243] Commission, 'Notice on the application of the State aid rules to measures relating to direct business taxation' OJ C384/3, 10 December 1998, para 16.
[244] 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' OJ C262, 19 July 2016, para 128.
[245] Case C-143/99 *Adria-Wien Pipeline* [2001] ECR I-8365, para 41; cf Joined Cases C-78/08 to C-80/08 *Paint Graphos* [2011] ECR I-7611, para 54.
[246] Case C-143/99 *Adria-Wien Pipeline* [2001] ECR I-8365.
[247] Joined Cases C-78/08 to C-80/08 *Paint Graphos* [2011] ECR I-7611; José Luis Buendía, 'Finding Selectivity or the Art of Comparison' (2018) EStAL 85.

referring Italian court asked the ECJ whether these exemptions were compatible with EU State aid rules. The ECJ applied the three-step test to verify selectivity.[248] In the first step, it identified the Italian corporate tax as the reference system in the broad sense.[249] In the second step, it emphasised that the factual and legal comparability of the situations of the beneficiaries and other undertakings must be assessed, i.e. the reference system in the strict sense. The ECJ concluded that cooperative societies are not in a comparable factual and legal situation to commercial companies and thus denied the existence of prima facie selectivity.[250] However, the ECJ also considered the alternative and therefore moved on to the third step, mentioning that in the present case there would be the possibility of a consistent and proportionate justification. The Court left it to the national court to determine whether the preferential treatment of cooperatives was justified or selective in this case.[251] In this case, the Court emphasised above all the importance of the comparability of situations and thus also the recourse to the concept of equal treatment.

The application of the three-step test depends on the type of tax measure, the point in time at which the tax burden is determined and the type of tax system or mechanism in question. The test applies when tax advantages or reductions are granted before the taxpayer's tax liability is calculated. This applies, for example, to tax exemptions, where undertakings are fully or partially exempt from paying a certain tax, or to reduced tax rates, where preferential rates apply to certain sectors or groups.[252] Tax mechanisms that affect the liability of taxpayers may also fall within the scope of the three-step test. These include depreciation rules that only benefit certain industries and rules on loss carry-forward or carry-back, which allow losses to be offset against future or past profits, if they are tailored to specific undertakings or restricted to specific sectors.[253] Even progressive or degressive tax rates can be selective if they are structured in such a way as to give certain undertakings a disproportionate advantage.[254] In addition, State interventions, such as tax rulings or administrative practices that create individual advantages

[248] Joined Cases C-78/08 to C-80/08 *Paint Graphos* [2011] ECR I-7611, para 49.
[249] Joined Cases C-78/08 to C-80/08 *Paint Graphos* [2011] ECR I-7611, paras 50ff.
[250] Joined Cases C-78/08 to C-80/08 *Paint Graphos* [2011] ECR I-7611, paras 54-63.
[251] Joined Cases C-78/08 to C-80/08 *Paint Graphos* [2011] ECR I-7611, paras 64-76.
[252] Eg Case C-143/99 *Adria-Wien Pipeline* [2001] ECR I-8365, where Austria's energy tax rebate system favoured companies producing goods over service providers; Joined Cases C-20/15 P and C-21/15 P *Commission v World Duty Free Group, Banco Santander and Santusa* [2016] ECLI:EU:C:2016:981, where Spain allowed certain undertakings to deduct goodwill arising from the acquisition of foreign subsidiaries, which benefited those making cross-border investments.
[253] Eg Case T-287/11 *Heitkamp BauHolding v Commission* [2016] ECLI:EU:T:2016:60, dealing with selective rules for loss carry-forwards in the event of corporate restructuring.
[254] Eg Case C-596/19 P *Commission v Hungary* [2021] ECLI:EU:C:2021:202, where Hungary's progressive turnover tax applied different rates depending on the size of the company.

for specific companies fall within the scope of the test.[255] Selectivity is easier to identify before tax liability because the preferential treatment, such as a tax exemption, is directly anchored in the rules. Mechanisms that come into play after tax liability, such as depreciation or loss-carry forward rules, are more nuanced and require an assessment of whether the advantage is inherent in the tax system or constitutes an unjustified deviation. Therefore, the three-step test is applied to different tax benefits and policy contexts. On the contrary, the three-step test does not apply to general tax policy decisions or broad fiscal policies that apply indiscriminately to all taxpayers.[256] Generally, measures accessible to all undertakings under the same conditions are not affected.[257] Adjustments or features inherent to the logic of the system are also generally not subject to the test, unless they result in unjustified discrimination.[258]

The following subchapters and the case law presented in them show that although the Court has further developed the three-step test, there are still many open issues. Due to the building blocks established over the years, the selectivity test and thus the three-step test is not a holistic approach, but is characterised by legal uncertainty on all sides. This chapter will show these shortcomings, which creates the basis for the hypothesis that a reorganisation of the selectivity test is required.

3.2.1. First Step: Definition of the Reference System

The first step of the three-step test involves the identification of a reference system. This constitutes the 'normal' or common non-discriminatory regime, against which any derogations are measured. The Court previously ruled that the determination of the reference system is particularly important in cases of tax measures, since the very existence of an advantage can only be determined when compared with the normal taxation.[259] Hence, the identification of the reference system serves as benchmark for the second and third step of the analysis and is thus crucial for its outcome. The reference system is composed of a collection of rules which are optimally based on objective criteria and that, in general, apply to those undertakings falling within its scope, as specified by its objective.[260] More concretely, "[i]n the case of taxes, the

[255] Eg Joined Cases C-885/19 P and C-898/19 P, *Fiat Chrysler Finance Europe v Commission* [2022] ECLI:EU:C:2022:859.
[256] Eg the establishment of a flat corporate income tax rate; eg Case C-518/13 *Eventech* [2015] ECLI:EU:C:2015:9, where London's policy of allowing black cabs to use bus lanes was uniformly applied to a specific group based on objective criteria.
[257] Eg Case T-461/12 *Hansestadt Lübeck v Commission* [2014] ECLI:EU:T:2014:758, where a general tax incentive for German airports was found to be non-selective because it applies generally without distinguishing between operators.
[258] Eg progressive taxation for income redistribution.
[259] Case C-88/03 *Portugal v Commission* [2006] ECR I-7115, para 56.
[260] 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' OJ C262, 19 July 2016, paras 132ff; Roland Ismer and Sophia Piotrowski, 'The Selectivity

reference system is based on such elements as the tax base, the taxable persons, the taxable event and the tax rates."[261] In fact, the 2016 Commission Notice provides little guidance on how to construct the reference system or tax base. There is no single term and definition for a reference system, a general tax measure or the notion of derogation. Therefore, it is of no surprise that a different understanding of the normal taxation may lead to divergent outcomes of the evaluation of tax benefits. The reference system may consist of general rules, which apply to all undertakings, such as the corporate income tax applied to all corporate taxpayers on the basis of their taxable income at a certain nominal rate, regardless of the amount (including flat taxes).[262] This may lead to the measure itself being considered the common regime, as in the *Gibraltar* case. Also in the Commission's view, the levy itself will usually be the reference system.[263] However, it may also be formed of exceptions to the general rules, e.g. loss carry-forward rules allowing taxpayers to carry over a tax loss to future years to offset a profit. Another presentation format of such reference system may be an exception to the exception. An example would be the exception to loss carry-forward provisions, prohibiting repurchasing investments within a certain time of selling them for a loss (so-called wash sales). Some of the rules apply to all taxpayers, while others deal with specific issues and therefore address only a limited number of taxpayers. Accordingly, it makes a big difference whether a broad or narrow reference system is chosen. Hence, as obvious as it sounds, it has to be borne in mind to compare only between situations, which are in fact comparable, both legally and factually. The purpose of this reference system becomes then important for the establishment of an objectively justified discrimination, examined in the third step.

There are barely any Court decisions on how the reference system is to be determined. Rather, the Court often agrees with the reference system established by the Commission without going into the details of that examination. In the *Gibraltar* judgment, the Court initially provided some useful criteria for guidance. It held that the non-taxation of offshore companies was not a random but an inevitable consequence of the system specifically designed to exclude from the

of Tax Measures: A Tale of Two Consistencies' (2015) 43 Intertax 559, 561-565; Steven Verschuur and Melina Stroungi, 'State Aid and Tax Rulings – the Commission's Approach to Virtual Payments: Equal Treatment of Multinationals?' (2017) EStAL 598, 600-601.

[261] 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' OJ C262, 19 July 2016, para 134.

[262] See eg Joined Cases C-78/08 to C-80/08 *Paint Graphos* [2011] ECR I-7611, paras 50-55.

[263] 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' OJ C262, 19 July 2016, para 134, referring to Case T-210/02 RENV *British Aggregates Association v Commission* [2012] ECLI:EU:T:2012:110, paras 49-50; C-88/03 *Portugal v Commission* [2006] ECR I-07115, para 56.

outset any taxation of those companies.[264] Moreover, it stressed that measures are not differentiated according to their objectives, but according to their effects, regardless of the regulatory technique or design used.[265] These guiding criteria were however not further pursued and elaborated in subsequent judgements of the Court. In the most recent cases, led by *Fiat*, the Court emphasised that the reference system must be rooted in the national law of the MS.[266]

The importance and the variety of options for the (correct) definition of the reference system is best illustrated by the examples on special purpose levies (dealing rather with the selectivity of disadvantages than advantages), loss carry-forward rules and the progressive nature of taxes. The selected cases illustrate that narrowing or expanding the reference system can lead to a completely different result. Although the MS' interpretation of the reference framework is not absolute, "the Commission bears the burden of proof in showing that the [MS'] interpretation is manifestly incorrect and incompatible with the wording and objectives of the national provisions".[267] It is also clear that the Commission (and the courts) are not in a position to judge how a State should design its tax system (see progressive taxes). The tax ruling cases, in particular the *Fiat* judgement, also make this clear once again. As the *Fiat* judgement has shed some more light on the composition, or rather the non-composition, of the reference system, this case will also be examined in a separate step.

To summarise, defining the reference framework in the context of tax measures is a particularly challenging task due to the diversity of tax mechanisms. To understand the nuances of this first step, it is helpful to examine how the Court has applied it to various forms of taxation. By examining specific cases, it is possible to gain a better understanding of how the general reference framework is defined and when a deviation from it is considered selective. Therefore, the following subchapters analyse the application of the first step to the tax forms of special purpose levies, loss carry-forward provisions and progressive taxation, drawing on the relevant CJEU case law. These examples illustrate the Court's approach to defining 'normal taxation'. The judgments in these three categories are the ones that go into the most detail when it comes to determining the reference system. This does not mean that these are the only relevant forms

[264] Joined Cases C-106/09 P and C-107/09 P *Commission and Spain v Government of Gibraltar and United Kingdom* [2011] ECR I-11113, paras 102, 106 and 107.
[265] Joined Cases C-106/09 P and C-107/09 P *Commission and Spain v Government of Gibraltar and United Kingdom* [2011] ECR I-11113, paras 87-92.
[266] See in particular Joined Cases C-885/19 P and C-898/19 P, *Fiat Chrysler Finance Europe v Commission* [2022] ECLI:EU:C:2022:859, para 74.
[267] Joined Cases C-555/22 P, C-556/22 P and C-564/22 P *United Kingdom v Commission and Others* [2024] ECLI:EU:C:2024:304, Opinion of AG Medina, para 65.

of tax. Other rules, such as depreciation rules,[268] tax reliefs or deductions[269] and parafiscal charges,[270] can also be examined under Art 107(1) TFEU for selectivity and thus also fall under the various stages of the test.

3.2.1.1. Example 1: Special Purpose Levies

As was previously addressed, certain taxes are levied to influence the behaviour of companies or correct market failures by being directed at specific economic activities or operators. In this case, the undertakings having to pay the special tax are disadvantaged vis-à-vis all other undertakings. A well-known example of this occurrence is the *British Aggregates* ruling.

In *British Aggregates*, the United Kingdom (UK) imposed a levy on aggregates with certain exemptions available. The Commission concluded that the levy concerned only certain sectors and undertakings as only the commercial exploitation of rock, sand and gravel would be charged when used as aggregates. Aggregates extracted as by-products or waste from other processes or recycled aggregates were not covered by the toll. However, the Commission was of the opinion that the levy was justified by the nature and general scheme of the system, which aimed at the reduction of non-renewable resources and the negative environmental impact.[271] The applicant, British Aggregates Association, argued that the UK Act treated similar situations differently. Accordingly, a large number of primary products were not subject to the levy, although their quarrying had the same impact as that of the materials concerned. The applicant, therefore, found the levy to intentionally exclude certain sectors from the levy to protect their competitiveness.[272] The GC considered the levy an environmental tax, which constitutes a burden on the commercial exploitation of virgin aggregates with the exception of certain materials. The GC reiterated that an environmental levy is an autonomous fiscal measure characterised by its environmental objective. It repeatedly held that MS retain the freedom to introduce sectoral environmental levies in the absence of coordination or harmonisation in that field. It follows that the mere fact that an environmental levy is a specific measure which cannot be considered part of a general tax system applicable to all similar activities having a comparable impact on the environment does not in principle mean that a selective advantage is granted to similar activities not subject to the levy. Hence, the choice of a MS to introduce such levy, even if based on the desire to maintain the international competitiveness of certain sectors,

[268] See Chapter 3.2.2.1.(b); eg Case C-128/16 P *Commission v Spain and Others* [2018] ECLI:EU:C:2018:591.
[269] Eg Joined Cases C-20/15 P and C-21/15 P *Commission v World Duty Free Group, Banco Santander and Santusa* [2016] ECLI:EU:C:2016:981.
[270] Eg Joined Cases C-792/21 P and C-793/21 P *AZ v Commission* [2024] ECLI:EU:C:2024:793.
[271] Case T-210/02 RENV *British Aggregates v Commission* [2006] ECR II-2789, paras 3-25.
[272] Case T-210/02 RENV *British Aggregates v Commission* [2006] ECR II-2789, paras 81-88.

would not undermine the consistency of such levy with environmental objectives.[273] In the first instance, the GC upheld the Commission decision and the finding of justified State aid.

On appeal, the ECJ rejected the Commission decision and the GC ruling. The ECJ held that the GC misinterpreted Art 107(1) TFEU by holding that MS are free to set their priorities as regards the protection of the environment with the result that if such levy does not apply to similar activities with comparable effects on the environment, this does not mean that these activities benefit from a selective advantage. This would exclude, as indicated by AG Mengozzi,[274] the possibility that the non-imposition of the levy on operators in similar situations might constitute a selective advantage.[275] The Court argued that requirements relating to environmental protection could not justify the exclusion of selective measures from the scope of Art 107(1) TFEU, regardless of the specificity of the levy.[276] Thus, the Court rejected the idea that the mere invocation of such an objective implies a lack of control of the consistency of the difference in treatment. In fact, it is settled case law that neither the fiscal nature nor the social or economic aim of a measure are sufficient to exclude it from the application of the State aid rules. Rather, measures are defined solely based on their effects, independently of the techniques used.[277] Thus, regardless of the fact that the advantage benefits those undertakings not subject to the levy, a distortion of competition exists nevertheless. As a consequence, the ECJ quashed the decision of the GC and referred the case back to it.

In the renvoi decision, the GC followed the three-step approach and identified the levy itself as reference system representing a specific tax system applicable to the aggregates sector. The GC maintained that the fact that aggregates made of certain materials are exempt from the levy and aggregates made of other materials are subject to the levy, even though the various aggregates are in a comparable situation as regards their use in the light of the environmental objective, amounts to a tax differentiation which may give rise to selective advantages. Given the inconsistency of the Act, the GC held that the objective of the protection of the environment is unlikely to be achieved.[278] Consequently, neither the objective of an environmental levy nor the

[273] Case T-210/02 RENV *British Aggregates v Commission* [2006] ECR II-2789, paras 114-117, 127-131, 144-146 and 171.
[274] Case C-487/06 P *British Aggregates v Commission* [2008] ECR I-10515, Opinion of AG Mengozzi, para 98.
[275] Case C-487/06 P *British Aggregates v Commission* [2008] ECR I-10515, paras 86-87.
[276] Case C-487/06 P *British Aggregates v Commission* [2008] ECR I-10515, para 92.
[277] Case C-487/06 P *British Aggregates v Commission* [2008] ECR I-10515, para 85; see also Case C-56/93 *Belgium v Commission* [1996] ECR I-723, para 79; Case C-241/94 *France v Commission* [1996] ECR I-4551, para 20.
[278] Case T-210/02 RENV *British Aggregates v Commission* [2012] ECLI:EU:T:2012:110, paras 51, 64, 75-76 and 89-90.

fact that it represents an exceptional burden for a particular sector excludes the levy from State aid scrutiny.

In a similar vein, in *Aer Lingus*, the ECJ agreed with the Commission and the GC that the measure itself constituted the reference system. In this case, Ireland introduced the air travel tax (ATT), an excise duty payable by aircraft passengers departing from an Irish airport and collected by the airline operators via increased ticket prices. Ireland foresaw two different rates, a lower and a higher one, depending on the distance between the departure and arrival airports. The Commission classified the higher ATT rate as the reference rate and concluded that the application of differentiated rates resulted in State aid to those airlines whose flights were subject to the lower rate. This followed from the fact that the lower rate in practice only applied to the 10-15% domestic flights, constituting the derogation. This finding was upheld on appeal by the GC and ultimately the ECJ.[279]

These cases show that earmarked or special purpose levies often form their own reference system in that they constitute subsystems within a given tax system. This naturally increases the risk that such levies will not be classified as State aid, since a deviation from the reference system cannot be established.[280] However, the ECJ has clarified in numerous cases that a tax must always be examined in the light of its actual effects and not in the light of the objectives it pursues. The specific purposes or objectives therefore do not shield special purpose levies from State aid scrutiny, as the levy must be consistent with the objective of the system. These cases show that the derogation test does not apply in every situation.[281] The only relevant question for the Court is whether the undertakings in a similar legal and factual situation are included within its scope of the special tax in light of its objective and, if not, whether this is justified.

3.2.1.2. Example 2: Loss Carry-Forward Rules

Almost all EU MS allow the carry-forward of losses. However, they also provide for anti-tax avoidance provisions to protect their tax base and prevent loss transfer to other companies (in the event of a change of ownership, unless justified).[282] The following examples of loss carry-

[279] Joined Cases C-164/15 P and C-165/15 P *Commission v Aer Lingus and Ryanair* [2016] ECLI:EU:C:2016:990, paras 8-20, 42 and 52-53.

[280] See also *Irish tax on sugar-sweetened drinks* (SA.45862) Commission Decision 2018/N [2018] OJ C180; *Danish saturated fat tax* (SA.33159) Commission Decision 2015/C [2019] OJ C94, where the objective of the special purpose levy was accepted (combating obesity).

[281] Cf Rita Szudoczky, *The Sources of EU Law and Their Relationships: Lessons for the Field of Taxation* (IBFD Doctoral Series 2014) 498-504.

[282] Dieter Endres and others (eds), *The Determination of Corporate Taxable Income in the EU Member States* (Kluwer Law International 2007) 80-82.

forward rules best illustrate the impact that the choice of reference system can have on the outcome of selectivity and that its determination is not always clear-cut but can occur at different levels of a tax.

The preliminary questions referred to the ECJ in the *P Oy* case were based on the Finnish law on income tax. The law foresaw the possibility to deduct losses from the profit from following tax years. However, it also included a rule which provided that in case of a change of ownership, losses will not be deductible. Notwithstanding that rule, the competent tax authority could nevertheless authorise a deduction, where this was necessary for the continuation of the company's activities.[283] The company P underwent ownership changes and therefore requested an authorisation for loss deduction from the tax authorities. Although P continued its business after the change of ownership, the application was rejected due to a lack of special reasons.[284] Uncertain about the determination of the reference system, the referring court identified two possible findings: either the general loss carry-forward rule (with the change of ownership rule as derogation therefrom), or the prohibition of loss deduction after a change of ownership (with the discretionary power of the authority as derogation therefrom).[285] The ECJ came to the conclusion that if it were established that the reference system consisted in a prohibition on the deduction of losses in cases of changes of ownership, and the authorisation procedure by the tax authorities as an exception thereto, such a tax regime would be capable of satisfying the condition of selectivity.[286] It can thus be inferred that the ECJ preferred the application of the first alternative for determining the reference framework.

The two cases *Heitkamp BauHolding* and *SinnLeffers* (*Sanierungsklausel* cases) concerned the German rules governing loss carry-forward and the exceptions thereto. The general rule that losses incurred during a tax year may be carried forward to subsequent tax years led to the acquisition of empty-shell companies (*Mantelkäufe*). Consequently, to counteract this phenomenon, the rule was restricted to all cases of changes of ownership of 25% or more of a company's share capital (rule governing the forfeiture of losses). The restructuring clause, an exception (to this exception), foresaw that in the event of a restructuring of the acquired undertaking the losses were not forfeited if the company was, or was likely to be, insolvent or

[283] Case C-6/12 *P* [2013] ECLI:EU:C:2013:525, paras 3-9.
[284] Case C-6/12 *P* [2013] ECLI:EU:C:2013:525, paras 10-11.
[285] Case C-6/12 *P* [2013] ECLI:EU:C:2013:525, paras 11-13.
[286] Case C-6/12 *P* [2013] ECLI:EU:C:2013:525, para 32.

over-indebted (*Sanierungsklausel*).[287] The two cases *Germany v Commission* deal with the exact same tax measure and are therefore not further examined.[288]

In the *Heitkamp BauHolding* case, the applicant Heitkamp BauHolding GmbH required restructuring and merged with its parent company Heitkamp KG, meeting the conditions for the application of the restructuring clause. After the Commission's formal investigation into Germany's restructuring clause and its qualification as State aid, the rule was annulled and disapplied.[289] The Commission decided that the rule governing the forfeiture of losses constituted the system of reference and the restructuring clause was an exception thereto, whereas the applicant believed that the loss-carry forward rule was the reference system while the forfeiture of losses was the exception and the restructuring clause merely re-established the general rule.[290] The GC upheld the Commission's finding confirming that "the general loss carry-forward rule, as limited by the rule governing the forfeiture of losses, constitutes the relevant framework" for assessing the selectivity of the measure.[291] The GC continued to determine whether the companies benefitting from the restructuring clause were in a comparable legal and factual situation to those companies subject to the forfeiture of losses rule. In this regard, it held that every undertaking which has undergone a change of ownership is in a comparable legal and factual situation, regardless of whether it experiences difficulties or not. The restructuring clause applying to a specific category only, namely those companies in difficulty (insolvent or over-indebted), favoured those undertakings in difficulty over undertakings not in difficulty but still undergoing a change of ownership (without risk of abuse). Hence, the rule differentiated between companies in comparable situations and was found to be prima facie selective.[292] According to the GC, the objective of the measure, to promote the restructuring of undertakings in difficulty and enabling those affected by the crisis to recover from insolvency, was extrinsic to the tax system and could therefore not justify the measure's selectivity.[293]

On appeal, the ECJ held that

[287] Case T-287/11 *Heitkamp BauHolding v Commission* [2016] ECLI:EU:T:2016:60, paras 1-14; Case T-620/11 *SinnLeffers v Commission* [2016] ECLI:EU:T:2016:59, paras 1-14.
[288] Case C-208/16 P *Germany v Commission* [2018] ECLI:EU:C:2018:506; Case C-209/16 P *Germany v Commission* [2018] ECLI:EU:C:2018:507.
[289] Case T-287/11 *Heitkamp BauHolding v Commission* [2016] ECLI:EU:T:2016:60, paras 15-35.
[290] Case T-287/11 *Heitkamp BauHolding v Commission* [2016] ECLI:EU:T:2016:60, paras 97-99.
[291] Case T-287/11 *Heitkamp BauHolding v Commission* [2016] ECLI:EU:T:2016:60, paras 106-107.
[292] Case T-287/11 *Heitkamp BauHolding v Commission* [2016] ECLI:EU:T:2016:60, paras 125-141.
[293] Case T-287/11 *Heitkamp BauHolding v Commission* [2016] ECLI:EU:T:2016:60, paras 164-167.

> "the selectivity of a tax measure cannot be precisely assessed on the basis of a reference framework consisting of some provisions that have been artificially taken from a broader legislative framework. Therefore, by thus excluding from the relevant reference framework in the present case the general rule of loss carry-forward, manifestly the General Court defined it too narrowly."[294]

Instead, the reference system should have consisted of the loss carry-forward rule. As a result of the error in the determination of the reference framework, the Court upheld the appeal in that the whole analysis of selectivity of the Commission and the GC became vitiated.[295]

As AG Wahl pointed out in his opinion, the case illustrates the difficulties in determining the reference system, which lies at the heart of the selectivity assessment. In his view, the crux of selectivity lies in the comparison of undertakings, which is only possible against a benchmark, i.e. the relevant reference system. Nonetheless, the AG admits that the Court has not yet defined how the correct reference system is to be understood, so that it is impossible to know with certainty what the 'normal' system is. In this context, AG Wahl also criticises the Commission, which has so far been unable to explain on what basis it determines the reference system, lacking clear objective criteria. Instead, he advocates a broad approach that includes all relevant provisions that influence the tax burden.[296] Applied to the present case, a narrow approach, such as the one adopted by the GC, would lead to a blurring of the first and second steps of the assessment.[297]

In the very similar *SinnLeffers* case, the applicant GFKL Financial Services AG was at risk of insolvency and required restructuring too. Thanks to a capital injection and increase by the new investor, that had bought almost 80% of the shares, the applicant was able to avoid insolvency. Resulting therefrom, the applicant fulfilled the conditions for the application of the German restructuring clause. Nevertheless, as was the case for *Heitkamp BauHolding*, after the Commission's State aid decision, the clause was disapplied and the possibility for loss carry-forward removed.[298] The GC decided the case on the same day as the *Heitkamp BauHolding* case and came to the same conclusion, namely that, as defined by the Commission, the rule

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[294] Case C-203/16 P *Andres (faillite Heitkamp BauHolding) v Commission* [2018] ECLI:EU:C:2018:505, para 103; Case C-208/16 P *Germany v Commission* [2018] ECLI:EU:C:2018:506, para 101.
[295] Case C-203/16 P *Andres (faillite Heitkamp BauHolding) v Commission* [2018] ECLI:EU:C:2018:505, paras 107-109; Case C-208/16 P *Germany v Commission* [2018] ECLI:EU:C:2018:506, paras 106-108.
[296] Case C-203/16 P *Andres (faillite Heitkamp BauHolding) v Commission* [2017] ECLI:EU:C:2017:1017, Opinion of AG Wahl, paras 93-109.
[297] Case C-203/16 P *Andres (faillite Heitkamp BauHolding) v Commission* [2017] ECLI:EU:C:2017:1017, Opinion of AG Wahl, paras 145-147.
[298] Case T-620/11 *SinnLeffers v Commission* [2016] ECLI:EU:T:2016:59, paras 15-20.

governing the forfeiture of losses constituted the reference framework.[299] However, this case's methodology significantly differed from that in *Heitkamp BauHolding*. The GC strictly followed the comparability approach: It first addressed the issue of the existence of prima facie selectivity.[300] This included the determination of the definition of the normal tax regime/system of reference.[301] Subsequently, it assessed the legal and factual situation of the undertakings requiring restructuring and considered the general character of the measure.[302] As a next step, it continued to assess whether the measure could be justified on the basis of the nature and general scheme of the German tax system.[303] Only after evaluating all these steps, the GC concluded that the measure was selective.

Again, on appeal, the ECJ ruled that the GC wrongly classified only the rule of forfeiture of losses as the reference system and excluded the general rule of loss carry forward from this reference system. By this exclusion, the GC had thus obviously interpreted the reference system too narrowly.[304] The determination of the reference system and the derogation therefrom is not merely focused on the wording or regulatory technique, but rather the intention and scope of the system as a whole. In this particular case, the ECJ however merely stated that the reference system is the loss carry-forward rule.[305]

Although the latter two cases show the different approach of the GC and the ECJ, the ECJ consistently applies a broader framework than the GC. The Court does not expressly answer the question of the right definition of the reference system, but stresses its importance and a correct assessment based on a measure's effects rather than legislative technique.

3.2.1.3. Example 3: Progressive Taxes

The recent cases *Commission v Poland* and *Commission v Hungary* deal with the determination of the reference system for progressive tax rates. *Commission v Poland* concerned a Polish direct business tax on the retail sector, the basis of assessment of which would be turnover and which would be progressive. The Commission considered the tax to be discriminatory because the progressive tax rates were linked to the size of undertakings and not to profitability. It determined the tax on the retail sector as the relevant reference system, excluding the progressive structure of the tax, which in turn constituted the derogation. The derogation could

[299] Case T-620/11 *SinnLeffers v Commission* [2016] ECLI:EU:T:2016:59, paras 114-115.
[300] Case T-620/11 *SinnLeffers v Commission* [2016] ECLI:EU:T:2016:59, paras 98ff.
[301] Case T-620/11 *SinnLeffers v Commission* [2016] ECLI:EU:T:2016:59, paras 104ff.
[302] Case T-620/11 *SinnLeffers v Commission* [2016] ECLI:EU:T:2016:59, paras 128ff.
[303] Case T-620/11 *SinnLeffers v Commission* [2016] ECLI:EU:T:2016:59, paras 149ff.
[304] Case C-209/16 P *Germany v Commission* [2018] ECLI:EU:C:2018:507, paras 97-104; Case C-219/16 P L*owell Financial Services v Commission* [2018] ECLI:EU:C:2018:508, paras 104-111.
[305] Phedon Nicolaides, 'The Definition of the Reference Tax System is still a Puzzle' (2018) EStAL 419, 425.

not be justified by the redistributive purpose, as only large undertakings were affected by such a progression in favour of smaller undertakings.[306] The GC annulled the Commission's decision and held that the progressivity of the tax was part of the reference system.[307] On appeal, the ECJ upheld the reasoning of the GC and recalled that, as with fundamental freedoms, MS are free to introduce progressive tax rates that take into account the taxpayers' ability to pay, also in the case of State aid. Thus, EU law does not exclude that the progression is based on turnover. As the Commission could not prove that the tax progression was designed in a discriminatory way, the progressivity had to be considered as part of the normal tax regime.[308] In her opinion, AG Kokott recalled that there are currently no constituent elements of a reference framework, leading to difficulties and concerns raised by many AGs. She pointed out that the determination of normal taxation raises the question of competence: are MS or the Commission competent to determine the reference framework? In this respect, MS are free to design their tax system as they see fit, including the application of progressive (turnover-based) taxation. Therefore, the AG argues that normal taxation cannot be derived from EU law, but must be decided by the national legislator. The Court's role is merely to review the internal logic of this law and remove inconsistencies.[309] An interesting point raised by the AG is the Commission's focus on a profit-based taxation. She makes the link to the international BEPS issue, where undertakings that make high profits reduce their tax base or shift their profits, distorting their actual ability to pay. In this regard, quite contrary to the Commission's perception, she noted that turnover-based income taxes are a growing trend.[310]

The *Commission v Hungary* case concerned a new progressive tax on turnover from the broadcasting or publication of advertising in Hungary with a transitional measure allowing loss carry-forward by undertakings that did not make a profit in 2013. The Court's reasoning is essentially the same as in *Commission v Poland*.[311] With regard to the loss carry-forward, the ECJ added that this mechanism should not be part of the reference system. The two categories of undertakings (those making profit and those not) are not in a comparable situation.[312]

[306] Case C-562/19 P *Commission v Poland* [2021] ECLI:EU:C:2021:201, paras 1-13.
[307] Case C-562/19 P *Commission v Poland* [2021] ECLI:EU:C:2021:201, para 24; see also Helene Hayden, 'Neues zum Dreistufentest – Zur Ermittlung des Referenzsystems bei progressiven Steuersätzen' in Thomas Jaeger and Birgit Haslinger (eds), *Jahrbuch Beihilferecht 20* (NWV 2020) 367ff.
[308] Case C-562/19 P *Commission v Poland* [2021] ECLI:EU:C:2021:201, paras 37-45.
[309] Case C-562/19 P *Commission v Poland* [2020] ECLI:EU:C:2020:834, Opinion of AG Kokott, paras 30-41.
[310] Case C-562/19 P *Commission v Poland* [2020] ECLI:EU:C:2020:834, Opinion of AG Kokott, paras 50-54.
[311] Case C-596/19 P *Commission v Hungary* [2021] ECLI:EU:C:2021:202, paras 30-53.
[312] Case C-596/19 P *Commission v Hungary* [2021] ECLI:EU:C:2021:202, paras 59-64.

The Court has rightly excluded the progressivity of taxes from the need for justification and even from a finding of prima facie selectivity (and thus comparability) from the outset. The underlying rationale of progressivity, namely the ability to pay of taxpayers, should not be regarded as an objective of a measure, but rather as the fundamental concept and philosophy of a State's tax system.

3.2.1.4. Preliminary Findings for the First Step

As far as the assessment of the special purpose levies is concerned, it can be seen that the reference system was initially formed at the instigation of the Commission by the general tax system, from which the levy deviated. This deviation was in any case justified by the environmental policy objectives of the levy. However, the ECJ (or the GC on renvoi) corrected this and stated that the special purpose levy itself is the reference system. In these special cases, there is therefore no exemption in the strict sense, but only an exemption for certain materials and thus for the economic operators. The argument of an environmental policy objective cannot therefore be used as justification here, as the extraction of other (similar but excluded) substances is just as harmful to the environment as the substances to which the levy applies. As such, special purpose levies often form a separate, own reference system, by representing subsystems within a specific tax system.

In the cases of loss carry-forward rules, however, the ECJ appears to take the opposite approach. While the reference system chosen by the Commission and the GC for special purpose levies was too broad and the ECJ called for a limitation, it considers the reference system chosen here to be too narrow and extends it on the grounds that the reference system would otherwise consist of an artificial mixture of individual rules. Only if the more general rule of loss carry-forward (and not the exceptions to it) is chosen can this lead to a meaningful reference system.

The case law on progressive taxation (and the tax ruling judgements, see Chapter 3.3. below) make it clear that the reference system should always be based on national law and cannot be derived from EU law, i.e. determined by the national legislator. The European courts can only scrutinise this national law for inconsistencies and errors in the logic of the law. Progressivity is part of the law itself and it is up to the MS to decide how they organise their tax system. Progressivity cannot therefore be regarded as an exemption or selective advantage in the sense of State aid. Ultimately, the question is not whether progressive taxes are illegal subsidies, which they are not, but whether it is discriminatory to adjust the tax so that all those who pay the highest rate are foreigners and all those who pay the lowest rate are nationals. This is an obiter dictum and was not addressed by the Court.

The series of tax rulings before the CJEU, such as *Starbucks*[313] or *Fiat*,[314] provided further clues for the correct definition of the reference system. The special case of tax rulings is dealt with in more detail in Chapter 3.3. The author has deliberately not included these cases here, as it is helpful to understand the beginnings of Commission and Court practice in order to understand the tax rulings. The extent to which the *Fiat* judgement, where the definition of the correct reference system was the central issue, contributed to the understanding and clarification of the composition of the reference system is therefore discussed in more detail below.

In this sense, the Court's view that "[t]he determination of the reference framework has a particular importance in the case of tax measures, since the very existence of an advantage may be established only when compared with 'normal' taxation",[315] cannot be fully endorsed. While it is true that a benchmark is necessary to determine whether undertakings are favoured over others, it is not always possible (without difficulty) to place the measure in question in a wider reference framework. Sometimes, as also recognised by the Court,[316] the reference system is formed by the tax measure itself. This means that the fact that a measure does not formally constitute a derogation cannot be equated with the existence of a general measure. Instead, greater emphasis should be placed on the comparability of undertakings, as is sought in the second step. This would avoid the establishment of a (sometimes) artificial 'normal' rule, but rather focus on the coherence of a measure with respect to its objective.

3.2.2. Second Step: Derogation from the Reference System – Comparability Approach

In a second step, it needs to be examined whether the fiscal measure at issue constitutes an exception to the previously identified reference system, thereby being prima facie selective. Since the landmark case *Adria-Wien Pipeline*, the Court employed a different method to the standard three-step test. The preliminary ruling referred by the Austrian Constitutional Court concerned energy tax rebates implemented within the framework of tax reforms. Pursuant to this law on the rebate of energy taxes, only undertakings whose activity consisted primarily in the production of goods were entitled to a rebate. The principal activity of Adria-Wien Pipeline GmbH, however, was the construction and operation of oil pipelines.[317] In order to assess whether the supply of energy on preferential terms constituted State aid, the Court performed a

[313] Joined Cases T-760/15 and T-636/16 *Netherlands v Commission* [2019] ECLI:EU:T:2019:669.
[314] Joined Cases T-755/15 and T-759/15 *Luxembourg v Commission* [2019] ECLI:EU:T:2019:670; Joined Cases C-885/19 P and C-898/19 P *Fiat Chrysler Finance Europe v Commission* [2022] ECLI:EU:C:2022:859.
[315] Case C-88/03 *Portugal v Commission* [2006] ECLI:EU:C:2006:511, para 56.
[316] Joined Cases C-106/09 P and C-107/09 P *Commission and Spain v Government of Gibraltar and United Kingdom* [2011] ECR I-11113, para 95.
[317] Case C-143/99 *Adria-Wien Pipeline* [2001] ECR I-8365, paras 3-9.

discrimination analysis comparing the situation of the beneficiary of the selective measure with the position of all other undertakings in an objectively comparable factual and legal situation.[318] It thus held that a tax measure is selective, when it favours undertakings "in comparison with other undertakings which are in a legal and factual situation that is comparable in the light of the objective pursued by the measure in question" (comparability).[319] Consequently, the mere finding of a derogation from the normal regime is not enough to constitute selectivity. The measure must additionally favour certain undertakings exclusively.[320] Hence, if comparable situations are treated differently, it is assumed that there is a selective tax benefit (prima facie selectivity). The existence of a discriminatory treatment was sufficient to fulfil the condition of selectivity.

Similarly, but even more consolidating, the ECJ in its decision *World Duty Free Group* emphasised the need to pursue a non-discrimination test under the second step.[321] It follows that an advantage can only be established when having regard to the normal taxation. Thus, the existence of a fiscal benefit requires that the contested measure is compared to another measure, the 'normal' one.[322] The general concept is therefore composed of, firstly, comparability and the search for whether the undertakings or situations being compared are objectively similar in light of the objective and logic of the reference system and, secondly, the existence of a derogation to the general application of the reference system that leads to selective advantages for certain undertakings or activities. Hence, the comparability assessment is integrated into the derogation analysis. The measure may be considered prima facie selective if it results in unequal treatment of comparable undertakings or situations within the same reference framework. In general, the more targeted the measure, the more likely it is to be categorised as a derogation.

The derogation or comparability approach can be applied to various tax aid mechanisms. For example, in cases concerning loss carry-forward rules, which allow certain undertakings to carry forward losses under more favourable conditions, the Court normally assesses whether the undertakings eligible for the favourable rules are comparable to those excluded under the general system. If they are comparable and are in fact treated differently, then there is a

[318] Case C-143/99 *Adria-Wien Pipeline* [2001] ECR I-8365, para 41.
[319] Case C-143/99 *Adria-Wien Pipeline* [2001] ECR I-8365, para 41.
[320] Case T-219/10 *Autogrill España v Commission* [2014] ECLI:EU:T:2014:939, paras 43-46.
[321] Joined Cases C-20/15 P and C-21/15 P *Commission v World Duty Free Group, Banco Santander and Santusa* [2016] ECLI:EU:C:2016:981, paras 93f; a discrimination assessment has equally been applied beforehand in Case C-487/06 P *British Aggregates v Commission* [2008] ECR I-10515, paras 82ff and in Case C-169/08 *Presidente del Consiglio dei Ministri* [2009] ECR I-10821, paras 59ff.
[322] See also Case C-88/03 *Portugal v Commission* [2006] ECR I-7115, para 56.

derogation.[323] For example, in the case of sector-specific measures, it is assessed whether the beneficiary sectors are genuinely different from other sectors.[324] Similar considerations apply to other rules, such as depreciations rules, i.e. the situation of those who benefit from a specific from a particular measure is compared with the situation of those who are subject to the general depreciation rules, or tax exemptions in general, i.e. the undertakings that are exempt from tax are compared with those that are still subject to tax.

Nevertheless, determining the comparable nature of situations may cause difficulties and is not always an obvious task. The broader or narrower the reference system, the easier or more difficult it becomes to identify a derogation. Determining whether undertakings or situations are objectively comparable often depends on the objective and logic of the measure. In some cases, comparability appears to pre-empt or merge with the justification analysis, leading to confusion about where these analyses fit. Certain mechanisms and systems make it difficult to distinguish between inherent characteristics and derogations (e.g. progressive tax rates). A comparison necessarily requires a benchmark.[325] Unfortunately, the case law demonstrates the incoherent use of various benchmarks. As will be illustrated below, the choice of comparator is crucial as it is directly linked to the outcome of the selectivity assessment. The Court developed a fairly flexible methodology for comparability by tailoring its analysis to the specific features of the respective tax system. Nevertheless, before a comparator is chosen, the problem arises in determining whether a measure is general or selective, the determination of which is important in order to find a derogation at all or not.

3.2.2.1. Drawing the Line: Distinguishing Between General and Selective Tax Measures to Identify Derogations

In tax matters, the predictability of the law is particularly important, as many companies are affected and tax measures are adopted under budgetary laws whose implementation is necessary for the proper functioning of the MS. It is, therefore, essential that there is a clear distinction between general and selective measures. Selectivity is the parameter, which differentiates favourable State aid measures from general ones. General measures are open to all economic actors operating within a MS or apply equally to all undertakings and productions in all economic sectors in a MS.[326] As already emphasised, tax schemes may be considered selective

[323] Eg Case C-6/12 *P* [2013] ECLI:EU:C:2013:525.
[324] Eg Case C-143/99 *Adria-Wien Pipeline* [2001] ECR I-8365.
[325] Case C-203/16 P *Andres (faillite Heitkamp BauHolding) v Commission* [2017] ECLI:EU:C:2017:1017, Opinion of AG Wahl, para 99.
[326] Commission, 'Notice on the application of the State aid rules to measures relating to direct business taxation' OJ C384/3, 10 December 1998, para 13.

if the national authorities enjoy a certain margin of discretion. The same is true for schemes, which affect only a specific part of the territory or of the economy (regional and sectoral aid schemes).[327] In contrast, according to Art 1(d) of Regulation 2015/1589, a lawful aid scheme is defined as

> "any act on the basis of which, without further implementing measures being required, individual aid awards may be made to undertakings defined within the act in a general and abstract manner and any act on the basis of which aid which is not linked to a specific project may be awarded to one or several undertakings for an indefinite period of time and/or for indefinite amount".

Accordingly, three cumulative conditions must be met: (1) it must be an act, (2) the aid must be granted without implementing measures being required, and (3) the beneficiary undertakings must be defined in the act in a general and abstract manner.[328] However, it is often not obvious whether a measure is general and lawful or indeed selective. Even general measures, which, at first sight, seem to apply to all undertakings in the same way may be de facto selective. The case law of the Court has tried to address the question of where and how to draw the line between a general measure and selective State aid, and thus a derogation. The following decisions are exemplary of the (not entirely simple) status quo and serve as an overview.

(a) Finding: *the system as a whole is selective*

The most propounding case is the *Gibraltar* ruling,[329] where a revised general corporate tax system was to be introduced in Gibraltar. The system of taxation foresaw a payroll tax, a business property occupation tax and a registration fee. In 2002, the Commission initiated a State aid procedure and two years later adopted a negative decision concluding that the reform was both regionally and materially selective. It held that the system favoured companies with no or low profits and companies without physical presence in the country.[330] The GC rejected the finding of regional selectivity. Regarding material selectivity, it quashed the Commission's decision, as it was not able to identify a derogation from the general system leading to a

[327] Hans Friederiszick, Lars-Hendrik Röller and Vincent Verouden, 'European State Aid Control: an economic framework' in Paolo Buccirossi (ed), *Handbook of Antitrust Economics* (MIT Press 2007) 5-6.

[328] Case C-362/19 P *Commission v Fútbol Club Barcelona* [2021] ECLI:EU:C:2021:169, paras 66-69; see also Case C-337/19 P *Commission v Belgium and Magnetrol International* [2020] ECLI:EU:C:2020:990, Opinion of AG Kokott, para 57.

[329] Joined Cases T-211/04 and T-215/04 *Government of Gibraltar and United Kingdom v Commission* [2008] ECR II-3745 and Joined Cases C-106/09 P and C-107/09 P *Commission and Spain v Government of Gibraltar and United Kingdom* [2011] ECR I-11113.

[330] Joined Cases T-211/04 and T-215/04 *Government of Gibraltar and United Kingdom v Commission* [2008] ECR II-3745, paras 16-21 and 26-30.

selective advantage. First, it ruled that the Commission failed in determining whether the various aspects of the tax reform would be capable of forming a common or normal tax regime in its own right. Quite on the contrary, the Commission simply found that the new aspects of the tax system constituted derogations, and therefore fulfilled prima facie selectivity. Second, it also failed to demonstrate that these aspects indeed constituted derogations and to assess any justification grounds.[331] Thus, according to the GC, the Commission made an error of law in the application of Art 107(1) TFEU.[332]

In his opinion, AG Jääskinen applied the derogation approach, but nevertheless stated that "neither the Commission nor the Court of Justice has succeeded in determining precisely what is covered by the term 'derogation from the norm' or what constitutes the 'norm' or 'a general system'".[333] Moreover, he emphasised the difficulty in determining what a normal tax rate actually is and outlined certain alternatives to the derogation-based approach.[334] The ECJ, however, sticked to its comparability approach.[335] It disagreed with the GC and stated that the approach followed by the GC does not allow the effects of the measure in question to be considered and thereby excludes from the outset the possibility of a selective advantage (incurred by offshore companies).[336] Moreover, it argued that the case law does not make the classification as selective conditional upon the fact that favoured undertakings are liable to the same tax burden but benefit from derogating provisions, representing the difference between the normal tax burden and that borne by other undertakings. This would mean that national tax rules fall outside the scope of EU State aid rules merely because they were adopted under a different regulatory technique, but nevertheless producing the same effects in law or fact.[337] The ECJ found that offshore companies were in fact favoured because the seemingly general criteria in practice discriminated between companies in a comparable situation with regard to the objective of the reform, namely the introduction of a Gibraltarian general system of

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[331] Joined Cases T-211/04 and T-215/04 *Government of Gibraltar and United Kingdom v Commission* [2008] ECR II-3745, paras 171-174.
[332] Joined Cases T-211/04 and T-215/04 *Government of Gibraltar and United Kingdom v Commission* [2008] ECR II-3745, para 187.
[333] Joined Cases C-106/09 P and C-107/09 P *Commission and Spain v Government of Gibraltar and United Kingdom* [2011] ECLI:EU:C:2011:215, Opinion of AG Jääskinen, para 184.
[334] Joined Cases C-106/09 P and C-107/09 P *Commission and Spain v Government of Gibraltar and United Kingdom* [2011] ECLI:EU:C:2011:215, Opinion of AG Jääskinen, paras 184-187; see also Michael Lang, 'State Aid and Taxation: Selectivity and Comparability Analysis' in Isabelle Richelle, Wolfgang Schön and Edoardo Traversa (eds), *State Aid Law and Business Taxation* (Springer 2016) 31.
[335] Joined Cases C-106/09 P and C-107/09 P *Commission and Spain v Government of Gibraltar and United Kingdom* [2011] ECR I-11113, para 75.
[336] Joined Cases C-106/09 P and C-107/09 P *Commission and Spain v Government of Gibraltar and United Kingdom* [2011] ECR I-11113, para 88.
[337] Joined Cases C-106/09 P and C-107/09 P *Commission and Spain v Government of Gibraltar and United Kingdom* [2011] ECR I-11113, paras 91-92.

corporate taxation.[338] The Court added that different tax burdens resulting from the application of a general regime is not sufficient on its own to establish selectivity and that, thus,

> "the criteria forming the basis of assessment which are adopted by a tax system […] [are] such as to characterise the recipient undertakings, by virtue of the properties which are specific to them, as a privileged category".[339]

According to the ECJ, this was sufficient to characterise the proposed system as selective. Offshore companies were only in the position to avoid taxation due to their specific features (no employees, no business premises).[340] It stressed the importance of the determination of the reference system as the existence of a selective benefit can only be established when compared to 'normal' taxation. However, it added that the selectivity qualification does not depend on the system being designed in accordance with a specific regulatory technique.[341] As a result, the ECJ, contrary to the GC, found the proposed tax reform to be materially selective.

This case is a nice transition from the analysis of the first step to the second. Although this is not a classic derogation case, but rather still concerns the determination of the reference system, it is once again clear that a measure does not always have to be a formal derogation in order to be assessed as selective. Often the focus is simply on the effects of a measure or system, with the background that in this particular case only offshore companies had an advantage.

(b) Finding: *the measure is open to all (not selective)*, appeal: *the measure is de facto selective*
In the joined cases *World Duty Free Group* ('Spanish goodwill'), the issue arose again as to how to distinguish general from selective tax measures. Similar to *Gibraltar*, the GC and the ECJ did not find a common denominator. The dispute arose on account of a provision introduced into the Spanish corporate tax law. The measure provided that, should an undertaking which is taxable in Spain acquire a minimum shareholding of 5% in a foreign company, held without interruption for at least one year, the goodwill resulting therefrom, which is recorded in the accounts as a separate intangible asset, may be deducted in the form of an amortisation from the basis of assessment for its corporate tax. The acquisition by an

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338 Joined Cases C-106/09 P and C-107/09 P *Commission and Spain v Government of Gibraltar and United Kingdom* [2011] ECR I-11113, paras 95-96 and 101.
339 Joined Cases C-106/09 P and C-107/09 P *Commission and Spain v Government of Gibraltar and United Kingdom* [2011] ECR I-11113, paras 103-104.
340 Joined Cases C-106/09 P and C-107/09 P *Commission and Spain v Government of Gibraltar and United Kingdom* [2011] ECR I-11113, paras 95-96 and 101-108.
341 Joined Cases C-106/09 P and C-107/09 P *Commission and Spain v Government of Gibraltar and United Kingdom* [2011] ECR I-11113, paras 90-92; see also Case C-6/12 *P* [2013] ECLI:EU:C:2013:525, paras 19 and 27; Case C-5/14 *Kernkraftwerke Lippe-Ems* [2015] ECLI:EU:C:2015:354, para 74.

undertaking, which is taxable in Spain of a shareholding in a company established in Spain, does not allow the goodwill to be recorded separately for tax purposes (even though it can be amortised).[342] The Commission argued that the effect of the measure was that the tax treatment of undertakings acquiring shareholdings of at least 5% in foreign companies differed from that applicable to those making identical acquisitions in companies established in Spain.[343] On the other side, the applicant claimed that the scheme at issue was not selective but in fact was a general scheme, which could apply to any undertaking taxable in Spain.[344]

The GC adopted the three-step assessment as method of analysis.[345] However, it additionally held that an exception from the reference system is not sufficient to establish selectivity, especially when a tax measure is potentially accessible to all undertakings. Instead, the measure must benefit a particular category of undertakings, which can be differentiated from the rest based on specific characteristics.[346] The GC based its reasoning on the ECJ's *Gibraltar* argumentation.[347] In that regard, the GC recalled that a measure benefitting all undertakings in the national territory cannot constitute State aid and consequently annulled the Commission decision.[348]

On the contrary, the ECJ decided that it is merely required that a measure derogating from the reference framework leads to discrimination without the need of a supplementary condition requiring the identification of a particular category of undertakings.[349] In this regard, the ECJ accused the GC of a misapplication of the selectivity criterion and of an excessively formalistic and restrictive approach, thereby contradicting itself and its earlier decision. According to the ECJ, the effect of the measure at issue was that the two categories of operators were distinguished and subject to different treatment, namely those falling within the scope of the

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[342] Case T-219/10 *Autogrill España v Commission* [2014] ECLI:EU:T:2014:939, paras 9-13; Case T-399/11 *Banco Santander and Santusa v Commission* [2014] ECLI:EU:T:2014:938, paras 14-18.
[343] Joined Cases C-20/15 P and C-21/15 P *Commission v World Duty Free Group, Banco Santander and Santusa* [2016] ECLI:EU:C:2016:981, para 22.
[344] Joined Cases C-20/15 P and C-21/15 P *Commission v World Duty Free Group, Banco Santander and Santusa* [2016] ECLI:EU:C:2016:981, para 33; cf Case C-55/19 P *Prosegur Compania de Seguridad v Commission* [2021] ECLI:EU:C:2021:797.
[345] Case T-219/10 *Autogrill España v Commission* [2014] ECLI:EU:T:2014:939, para 33; Case T-399/11 *Banco Santander and Santusa v Commission* [2014] ECLI:EU:T:2014:938, para 37.
[346] Case T-219/10 *Autogrill España v Commission* [2014] ECLI:EU:T:2014:939, paras 45-52; Case T-399/11 *Banco Santander and Santusa v Commission* [2014] ECLI:EU:T:2014:938, paras 81 and 85.
[347] Case T-219/10 *Autogrill España v Commission* [2014] ECLI:EU:T:2014:939, para 67; Case T-399/11 *Banco Santander and Santusa v Commission* [2014] ECLI:EU:T:2014:938, para 71; Joined Cases C-106/09 P and C-107/09 P *Commission and Spain v Government of Gibraltar and United Kingdom* [2011] ECR I-11113, paras 103, 104 and 107.
[348] Case T-219/10 *Autogrill España v Commission* [2014] ECLI:EU:T:2014:939, paras 70 and 83-84; Case T-399/11 *Banco Santander and Santusa v Commission* [2014] ECLI:EU:T:2014:938, paras 74 and 87-88.
[349] Joined Cases C-20/15 P and C-21/15 P *Commission v World Duty Free Group, Banco Santander and Santusa* [2016] ECLI:EU:C:2016:981, paras 70-74.

derogating measure and those falling within the scope of the ordinary system, despite being in a comparable situation in light of the objective pursued.[350] The measure at issue was designed to facilitate exports and cross-border investment transactions to the disadvantage of undertakings carrying out transactions of the same kind within the Spanish territory.[351] Further, factors such as the large number of undertakings entitled, the size of a company or the affiliation to a certain economic sector, are not sufficient to call into question the selective nature.[352] In line with the AG's opinion,[353] it was clarified that the availability of the benefits to a large number of companies does not call into question the selective nature of the measure but only the degree of selectivity. Rather, the defining criterion is whether the measure puts the beneficiaries in a more favourable financial situation than others in a comparable situation, whatever their nature, their pursued activities or operations. In other words, even measures that are open to all companies can be selective.[354] Moreover, the application of the *Gibraltar* case law was excluded due to a lack of commonalities. In *Gibraltar*, there was no derogation from a normal regime, as the normal regime was held to be discriminatory in itself.[355] Accordingly, the ECJ set the judgements under appeal aside and did not side with the GC's restrictive interpretation of Art 107(1) TFEU but rather confirmed the broad scope of the State aid rules.

In its renvoi decision, the GC corrected itself and agreed with the Commission that the measure derogated from the normal regime in that the

> "emphasis has […] been placed on a concept of selectivity which is based on the distinction between undertakings which choose to perform certain transactions and other undertakings which choose not to perform them, and not on the distinction between the undertakings from the perspective of their specific characteristics. […]
> It follows that a national tax measure such as the measure at issue, which grants an advantage upon satisfaction of the condition that an economic transaction is performed, may be selective including where, having regard to the characteristics

[350] Joined Cases C-20/15 P and C-21/15 P *Commission v World Duty Free Group, Banco Santander and Santusa* [2016] ECLI:EU:C:2016:981, para 77.
[351] Joined Cases C-20/15 P and C-21/15 P *Commission v World Duty Free Group, Banco Santander and Santusa* [2016] ECLI:EU:C:2016:981, paras 116-119.
[352] Joined Cases C-20/15 P and C-21/15 P *Commission v World Duty Free Group, Banco Santander and Santusa* [2016] ECLI:EU:C:2016:981, para 80.
[353] Joined Cases C-20/15 P and C-21/15 P *Commission v World Duty Free Group, Banco Santander and Santusa* [2016] ECLI:EU:C:2016:624, Opinion of AG Wathelet, paras 8 and 83.
[354] Joined Cases C-20/15 P and C-21/15 P *Commission v World Duty Free Group, Banco Santander and Santusa* [2016] ECLI:EU:C:2016:981, paras 80-82.
[355] Joined Cases C-20/15 P and C-21/15 P *Commission v World Duty Free Group, Banco Santander and Santusa* [2016] ECLI:EU:C:2016:981, paras 71-76.

> of the transactions concerned, any undertaking may freely choose to perform that transaction."[356]

The GC specified that undertakings acquiring shareholdings in non-resident companies and those acquiring shareholdings in resident companies were in a comparable factual and legal situation. Thus, the measure at issue did not introduce a clearly defined tax system or new general rule but was merely a particular way of applying a wider-ranging tax and therefore was an exception/derogation to the general rule.[357] The justification ground of fiscal neutrality could not be upheld.[358]

The company World Duty Free Group and Spain sought a second appeal before the ECJ alleging an infringement of the selectivity condition under Art 107(1) TFEU. The Court, in a preliminary note, covered the determination of the reference framework and clarified that it

> "must follow from an objective examination of the content, the structure and the specific effects of the applicable rules under national law of that State. In that regard, the selectivity of a tax measure cannot be assessed on the basis of a reference framework consisting of some provisions of the national law of the Member State concerned that have been artificially taken from a broader legislative framework".[359]

Thus, if a tax measure cannot be separated from the general tax system, then reference must be made to that system. If, however, a measure is indeed separable from the general system, the reference system is more limited and might even consist of the measure itself.[360] In this regard, the applicants argued that the GC substituted its own reference system (system of financial and non-financial goodwill) for the one identified by the Commission (system of financial goodwill). In response, the ECJ and the Commission contended that the framework was not limited to the treatment of financial goodwill but could be assimilated thereto.[361] The Court recalled that the seeming general nature of the measure does not mean that it cannot be selective.

[356] Case T-219/10 RENV *World Duty Free Group v Commission* [2018] ECLI:EU:T:2018:784, paras 83 and 88; Case T-399/11 RENV *Banco Santander and Santusa v Commission* [2018] ECLI:EU:T:2018:787, paras 84 and 89.
[357] Case T-219/10 RENV *World Duty Free Group v Commission* [2018] ECLI:EU:T:2018:784, paras 121-124 and 134-135; Case T-399/11 RENV *Banco Santander and Santusa v Commission* [2018] ECLI:EU:T:2018:787, paras 135-136.
[358] Case T-219/10 RENV *World Duty Free Group v Commission* [2018] ECLI:EU:T:2018:784, paras 165ff; Case T-399/11 RENV *Banco Santander and Santusa v Commission* [2018] ECLI:EU:T:2018:787, paras 166ff.
[359] Case C-51/19 P *World Duty Free Group v Commission* [2021] ECLI:EU:C:2021:793, para 62.
[360] Case C-51/19 P *World Duty Free Group v Commission* [2021] ECLI:EU:C:2021:793, para 63.
[361] Case C-51/19 P *World Duty Free Group v Commission* [2021] ECLI:EU:C:2021:793, paras 69-74.

Thus, the measure at issue did not present a new rule but an exception to the general rule that the amortisation of goodwill is only possible in case of business combinations, introducing differences in the treatment of operators being in a comparable factual and legal situation in light of the objective of the system.[362] The appeal was dismissed in its entirety and the classification as aid was confirmed once and for all.[363]

The *World Duty Free Group* case law shows that the issue around the correct application of the three-step test is still not resolved. The condition previously established by the ECJ that a certain category of companies must be identified did not apply here and therefore cannot be regarded as a condition of general validity. The argumentation ultimately pursued is highly open to critique, as it makes no sense to consider as selective a measure that is in principle open to all companies but is only taken up by those companies that opt for a particular transaction. This will inevitably lead to preferential treatment. The literature describes this as a shift from structural to behavioural selectivity, as the Court previously focused on characteristics such as the size of the company or which sector it operates in. Now it refers more specifically to the actions, transactions and investments that the company undertakes (or does not undertake).[364] Yet, what matters is not whether undertakings chose to perform certain activities in order to benefit from the measure, but whether the measure was open to all undertakings equally from the start, without discrimination. Even if companies then take advantage of the rules and enjoy certain benefits, as opposed to others, there should not be a problem of selectivity in this case.[365] Above all, the Court had no regard whatsoever to the non-discrimination test it previously referred to. This approach of the Court leads to a very broad understanding of selectivity.

A similar case is that of the *Spanish Tax Lease (STL) System*. In 2006, several complaints were brought before the Commission concerning the application of the STL System to certain finance lease agreements, as it allowed shipping companies to obtain a discount of 20-30% for the purchase of ships built by Spanish shipyards. Each vessel order involved a bank, a shipping company, a shipyard, a leasing company and an economic interest grouping (EIG) (consisting of the bank and the investors).[366] The tax measures at stake enabled the tax-transparent EIG to

[362] Case C-51/19 P *World Duty Free Group v Commission* [2021] ECLI:EU:C:2021:793, paras 97-99.
[363] Case C-51/19 P *World Duty Free Group v Commission* [2021] ECLI:EU:C:2021:793, para 157.
[364] See eg Dimitrios Kyriazis, 'The Court of Justice's Judgments in the Spanish Goodwill cases: Clarifying Selectivity in State Aid Law?' (2021) EU Law Live; Phedon Nicolaides, 'Excessive Widening of the Concept of Selectivity' (2017) EStAL 62, 62ff; Jacques Derenne, 'Commission v World Duty Free Group a.o.: Selectivity in (Fiscal) State Aid, quo vadis Curia?' (2017) 8(5) JECLAP 311.
[365] Cf Case C-156/98 *Germany v Commission* [2000] ECR I-6857.
[366] Joined Cases T-515/13 and T-719/13 *Spain and Others v Commission* [2015] ECLI:EU:T:2015:1004, paras 1-15; cf Joined Cases T-700/13, T-2/14, T-6/14, T-10/14, T-16/14, T-18/14, T-24/14, T-465/14, T-467/14, T-469/14, T-471/14, T-472/14, T-473/14, T-474/14, T-476/14, T-477/14, T-478/14, T-482/14, T-483/14, T-491/14, T-

benefit from early and accelerated depreciation of the leased vessels, the loss being subsequently deductible from the investors' revenues pro rata to their shares in the EIG. As a result of the EIG's switchover to the tonnage tax system, the capital gains from the sale of the vessel were fully tax exempt.[367] According to the Commission, the purpose of the system was to grant tax benefits to the EIGs and investors involved, which would subsequently be passed on to the shipping companies acquiring the vessels.[368] Although the STL System was composed of various measures, the Commission found the measures to be linked together de jure or de facto, and thus classified them as a system/scheme.[369] Indeed, it found the STL as a whole to be selective due to the discretionary powers of the tax authority and the imprecise wording of the conditions. Moreover, certain measures were sectoral selective, as they were only applicable to maritime transport activities.[370] The Commission concluded that the STL system was composed of five tax measures, three of which satisfied the conditions of Art 107(1) TFEU.[371]

The GC ruled that despite the discretionary elements (authorisation system), the advantages remained available to any investor participating in the STL operations. Moreover, the advantage acquired a general nature being available on the same terms to any undertaking based on a certain type of investment available to any operator and did not constitute a selective advantage.[372] As a result, the GC did not find selectivity in favour of the EIGs and the investors.[373] The ECJ, on the contrary, came to the conclusion that not only the investors, but also the EIGs should be regarded as the beneficiaries of the measure and as undertakings carrying out economic activity within the meaning of Art 107(1) TFEU.[374] According to the ECJ, the GC erred in law in assessing the condition of selectivity based on the incorrect premise that only the investors, and not the EIGs, could be regarded as beneficiaries of the measure.[375]

701/13, T-702/13, T-703/13, T-704/13 and T-705/13 *Caixabank v Commission* [2024] ECLI:EU:T:2024:295; Joined Cases T-29/14 and T-31/14 *Telefónica Gestión Integral de Edificios y Servicios v Commission* [2024] ECLI:EU:T:2024:110; Case T-508/14 *Gas Natural v Commission* [2024] ECLI:EU:T:2024:319; Case T-514/14 *Hispavima v Commission* [2024] ECLI:EU:T:2024:274; Case T-519/14 *Grupo Morera & Vallejo and DSA v Commission* [2024] ECLI:EU:T:2024:194.

[367] Joined Cases T-515/13 and T-719/13 *Spain and Others v Commission* [2015] ECLI:EU:T:2015:1004, paras 18-20.

[368] Joined Cases T-515/13 and T-719/13 *Spain and Others v Commission* [2015] ECLI:EU:T:2015:1004, paras 16ff.

[369] Joined Cases T-515/13 and T-719/13 *Spain and Others v Commission* [2015] ECLI:EU:T:2015:1004, paras 33ff.

[370] Joined Cases T-515/13 and T-719/13 *Spain and Others v Commission* [2015] ECLI:EU:T:2015:1004, para 45.

[371] Joined Cases T-515/13 and T-719/13 *Spain and Others v Commission* [2015] ECLI:EU:T:2015:1004, para 97.

[372] Joined Cases T-515/13 and T-719/13 *Spain and Others v Commission* [2015] ECLI:EU:T:2015:1004, paras 148 and 158ff.

[373] Joined Cases T-515/13 and T-719/13 *Spain and Others v Commission* [2015] ECLI:EU:T:2015:1004, paras 178-180.

[374] Case C-128/16 P *Commission v Spain and Others* [2018] ECLI:EU:C:2018:591, paras 44-46.

[375] Case C-128/16 P *Commission v Spain and Others* [2018] ECLI:EU:C:2018:591, para 58.

In addition, the ECJ rejected the GC's view that the advantages received by the investors were not selective, since they were available to any undertaking under the same conditions. Indeed, the GC failed to ascertain whether the Commission appraised the existence of a differentiated treatment of operators in a comparable legal and factual situation.[376] As a result, the ECJ set aside the judgement of the GC.[377]

In its judgment of 2020, following the ECJ's referral, the GC dismissed the actions. It ruled that in the light of the discretionary powers of the authority regarding the prior authorisation scheme and based on unclear criteria (such as to the date of commencement of depreciation), the beneficiaries of the measure were placed in a more favourable position compared to taxpayers in comparable legal and factual situations. Accordingly, the measure could not be regarded as being of a general nature, due to the discretion exercised.[378] Hence, the Commission was right to consider the STL System as a whole to be selective.[379]

In a second appeal, the ECJ finally confirmed the selective character of the STL System and that it constitutes unlawful aid.[380] It partially annulled the judgement of the GC and the Commission's decision by holding that the part of the tax advantage transferred by the EIG to the shipping companies must be deducted from the recoverable aid as it results from a contractual obligation between the parties.[381] The judgment as it stands leaves the Commission room for interpretation as regards the recovery of the aid. It may decide to adopt a new decision or recover the aid from all beneficiaries, including the shipping companies, which would likely lead to new litigation.

In both cases, appeals were lodged twice before the ECJ, which means that both the GC and the ECJ judged the cases twice. Such a procedure is not usual, but it does illustrate what a ping-pong sport this topic is and the extent to which the courts of the same institution differ in their views.

[376] Case C-128/16 P *Commission v Spain and Others* [2018] ECLI:EU:C:2018:591, para 71.
[377] Case C-128/16 P *Commission v Spain and Others* [2018] ECLI:EU:C:2018:591, para 103.
[378] Joined Cases T-515/13 RENV and T-719/13 RENV *Spain v Commission* [2020] ECLI:EU:T:2020:434, paras 88ff.
[379] Joined Cases T-515/13 RENV and T-719/13 RENV *Spain v Commission* [2020] ECLI:EU:T:2020:434, paras 93 and 100-101.
[380] Joined Cases C-649/20 P, C-658/20 P and C-662/20 P *Spain v Commission* [2023] ECLI:EU:C:2023:60.
[381] Joined Cases C-649/20 P, C-658/20 P and C-662/20 P *Spain v Commission* [2023] ECLI:EU:C:2023:60, para 138.

(c) Finding: *the measure constitutes a selective aid scheme*

The background to the dispute in *Magnetrol International* was the longstanding practice of Belgian tax authorities awarding tax rulings to undertakings of cross-border groups to adjust their profits (so-called excess profits)[382] if they could demonstrate the existence of a new situation (e.g. reorganisation). This resulted from the correlative adjustment (adjustment to the taxable profit) newly introduced for cross-border transactions of associated undertakings forming part of a multinational group, thereby explicitly including the arm's length principle (ALP).[383] The Commission found that the downward adjustment to the profits of 55 Belgian companies by means of 66 advance rulings by the tax authorities constituted an aid scheme incompatible with Art 107(1) TFEU. The Commission found that the exemptions were a systematic technical application of a scheme without the need for further implementing measures, based on the new Belgian acts referring to undertakings forming part of multinational companies, and which defined the beneficiaries in a general and abstract manner. In this regard, the Commission defined the Belgian corporate income tax system as the reference system and the excess profit scheme as a derogation therefrom. It considered the scheme selective since only Belgian undertakings belonging to multinational groups could benefit from it.[384]

The GC did not side with the Commission, but instead agreed with Belgium and Magnetrol International that the parameters to be taken into account for the calculation of the excess profit and the issuance of tax rulings were not set out in the relevant national acts, on which the scheme was supposedly based. Thus, the Court held that the Belgian tax authorities still enjoyed a margin of discretion.[385] Moreover, the Commission did not explain its choice of a sample of 22 of the 66 advance rulings or why it considered it to be representative of all advance rulings involved. Hence, it could not prove that the tax authorities followed a systematic approach.[386] As a result, the GC annulled the contested decision and held that the Commission erroneously considered the excess profit system to constitute an aid scheme.[387]

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[382] Excess profits are profits exceeding the profit that would have been made by comparable stand-alone undertakings in similar circumstances.

[383] Joined Cases T-131/16 and T-263/16 *Belgium and Magnetrol International v Commission* [2019] ECLI:EU:T:2019:91, paras 1-14.

[384] Joined Cases T-131/16 and T-263/16 *Belgium and Magnetrol International v Commission* [2019] ECLI:EU:T:2019:91, paras 15-26.

[385] Joined Cases T-131/16 and T-263/16 *Belgium and Magnetrol International v Commission* [2019] ECLI:EU:T:2019:91, para 111.

[386] Joined Cases T-131/16 and T-263/16 *Belgium and Magnetrol International v Commission* [2019] ECLI:EU:T:2019:91, para 127.

[387] Joined Cases T-131/16 and T-263/16 *Belgium and Magnetrol International v Commission* [2019] ECLI:EU:T:2019:91, para 135.

The Commission appealed the ruling alleging that the GC erred in its interpretation of the concept of an aid scheme.[388] It demanded a broader interpretation of the concept encompassing a consistent administrative practice.[389] In her opinion, AG Kokott clarified that the GC did not rule out the possibility that a systematic approach could indeed meet the requirements of an aid scheme, but merely concluded that the Commission had not demonstrated a consistent administrative practice. Thus, the question was rather whether the GC imposed excessive requirements for its demonstration.[390] In this regard, it was not necessary that the Commission examines all contested rulings individually but must prove that the selection of a sample is representative. In the present case, the Commission sufficiently explained its choice.[391] Additionally, the AG stated that in presence of a consistent administrative practice as an act, no further implementing measures are required.[392] Consequently, the appeal was held to be well founded by the AG.[393]

In its judgment from September 2021, the ECJ followed the AG's opinion, set aside the judgment of the GC and referred the case back to the latter.[394] It supported the conclusion that the systematic contra legem application of national tax provisions by tax authorities is able to constitute a consistent administrative practice.[395] In this regard, it considered that the GC misapplied the conditions for the existence of an aid scheme as it did not sufficiently take into account the Commission's reasoning in its decision.[396] Moreover, the ECJ held that the Belgian tax authorities had no discretion, but systematically granted the excess profit exemption when the necessary requirements were satisfied, concluding that the excess profit exemption scheme could be considered an aid scheme.[397] Hence, the ECJ opened the door for the examination by

[388] Case C-337/19 P *Commission v Belgium and Magnetrol International* [2020] ECLI:EU:C:2020:990, Opinion of AG Kokott, para 53.
[389] Case C-337/19 P *Commission v Belgium and Magnetrol International* [2020] ECLI:EU:C:2020:990, Opinion of AG Kokott, para 63.
[390] Case C-337/19 P *Commission v Belgium and Magnetrol International* [2020] ECLI:EU:C:2020:990, Opinion of AG Kokott, paras 67 and 69.
[391] Case C-337/19 P *Commission v Belgium and Magnetrol International* [2020] ECLI:EU:C:2020:990, Opinion of AG Kokott, paras 79ff.
[392] Case C-337/19 P *Commission v Belgium and Magnetrol International* [2020] ECLI:EU:C:2020:990, Opinion of AG Kokott, para 103.
[393] Case C-337/19 P *Commission v Belgium and Magnetrol International* [2020] ECLI:EU:C:2020:990, Opinion of AG Kokott, para 114.
[394] Case C-337/19 P *Commission v Belgium and Magnetrol International* [2021] ECLI:EU:C:2021:741, paras 168 and 171.
[395] Case C-337/19 P *Commission v Belgium and Magnetrol International* [2021] ECLI:EU:C:2021:741, para 81.
[396] Case C-337/19 P *Commission v Belgium and Magnetrol International* [2021] ECLI:EU:C:2021:741, paras 93-99.
[397] Case C-337/19 P *Commission v Belgium and Magnetrol International* [2021] ECLI:EU:C:2021:741, paras 11-113.

the Commission as a package of a large number of tax rulings without having to look into each one individually.

In its renvoi decision, the GC started its analysis by determining the reference system. Although it found that the parties agreed in principle that the normal Belgian corporate income tax system constituted the reference system, it re-emphasised the importance of the correct identification with regard to national law and its objective. One point of contention between Belgium and the Commission was that the Commission had not included the excess profit scheme in the reference system on the ground that the relevant national provision did not provide for this. The GC confirmed the Commission's finding.[398] The GC then examined the existence of an advantage. This seems rather odd. On the one hand, the GC recognised that selectivity and advantage are indeed different criteria. On the other hand, it argued that these criteria can be examined together as the third condition (selective advantage) of Art 107(1) TFEU.[399] As regards the derogation from the reference system, it was found that the scheme, or more precisely the administrative practice of the tax authorities, constituted a derogation from the general rule according to which the profit actually realised is taxed, as it was not part of the national provision. Moreover, the scheme was not available to all companies in a similar legal and factual situation, but only to those that were part of a multinational group.[400] The scheme could not be justified as it was not aimed at avoiding actual or potential double taxation.[401]

In 2022, the GC ruled in a similar case on an aid scheme introduced by Gibraltar, which provided for a general corporate tax rate of 10% and a tax exemption for interest and royalty income. Following the complaint of Spain, the Commission opened a formal investigation procedure to determine whether this non-taxation of passive interest and royalty income selectively favoured offshore companies or companies belonging to multinational groups. It found that the measure was a priori selective and considered that five out of 165 advance tax rulings derogated from the ordinary system.[402] The GC agreed with the Commission that the reference system was the corporate income tax with the objective of collecting income tax from taxpayers receiving income accrued in or derived from Gibraltar. The non-taxation of royalty income was thus considered a derogation (implicit exemption) since the companies benefitting from the non-taxation and belonging to multinational groups are in a similar legal and factual situation as the Gibraltar resident companies deriving income there. Therefore, the non-taxation

[398] Case T-131/16 RENV *Belgium v Commission* [2023] ECLI:EU:T:2023:561, paras 35-81.
[399] Case T-131/16 RENV *Belgium v Commission* [2023] ECLI:EU:T:2023:561, paras 82-106.
[400] Case T-131/16 RENV *Belgium v Commission* [2023] ECLI:EU:T:2023:561, paras 107-142.
[401] Case T-131/16 RENV *Belgium v Commission* [2023] ECLI:EU:T:2023:561, paras 143-149.
[402] Case T-508/19 *Mead Johnson Nutrition* [2022] ECLI:EU:T:2022:217, paras 1-25.

of royalty income was classified as a selective aid scheme.[403] *Gibraltar* thus shows again that a formal derogation is not necessary to fulfil the condition of selectivity.

3.2.2.2. Comparability (stricto sensu)

As previously mentioned, the Court follows a comparability analysis under the second step, comparing the legal and factual situation of undertakings in light of the objective pursued by the measure in question. The case law presented in this section will demonstrate the Court's reasoning in assessing the comparability of undertakings so that they can be considered to be in a similar factual and legal situation.

(a) Finding: *different treatment of comparable undertakings (selective measure)*

The *A-Brauerei* case concerned a preliminary reference by the German Federal Finance Court. By way of merger, the company A-Brauerei received all of the assets of T-GmbH in which it held 100% of the shares. The German Law on real property transfer tax foresaw an exception to tax in case a controlling and one or more dependent companies (with a shareholding of at least 95% during a minimum uninterrupted period of five years) were involved in the restructuring. The tax authority classified the transfer as a taxable event, subject to real property transfer tax, as it did not consider T-GmbH as a dependent company anymore after its cessation following the merger. Next to deciding whether A-Brauerei was indeed eligible for the tax benefit, the referring court raised the issue of whether the German exception constituted State aid or not.[404]

In assessing whether the tax advantage must be characterised as general and therefore, as compatible with Art 107 TFEU, the ECJ repeated its *World Duty Free Group* reasoning that it is irrelevant whether a measure enables or not the identification of a particular category of undertakings, which can be distinguished via specific properties and characteristics common to them.[405] Rather, the Court looked at the objective and the effects of the measure: The exemption under German law sought to facilitate restructurings and structural changes involving property transfers between companies to make them more competitive in light of the negative impact of the financial crisis. However, the measure only favoured groups of companies involved in restructurings, excluding those companies not forming part of groups. Contrary to the AG's opinion,[406] the Court held that these two categories of operators were subject to a different

[403] Case T-508/19 *Mead Johnson Nutrition* [2022] ECLI:EU:T:2022:217, paras 198ff.
[404] Case C-374/17 *A-Brauerei* [2018] ECLI:EU:C:2018:1024, paras 5-17.
[405] Case C-374/17 *A-Brauerei* [2018] ECLI:EU:C:2018:1024, para 27.
[406] Case C-374/17 *A-Brauerei* [2018] ECLI:EU:C:2018:741, Opinion of AG Saugmandsgaard Øe, para 114, where the AG classified the German measure as a general and not selective one.

treatment although being in a comparable situation in light of the objective pursued, that is to tax the change of ownership.[407] Nevertheless, in the last step of assessment, the Court concluded that the exemption's objective, namely the avoidance of double and excessive taxation, justified the distinction introduced by it.[408]

Of particular interest in this case are the statements made by the AG in his Opinion. Similar to AG Jääskinen in *Gibraltar*, AG Saugmandsgaard Øe expressed concerns as regards the risks entailed in the derogation approach. He pointed out that the assessment method bears the risk of extending the State aid rules to any tax differentiations, encouraging the review of national tax systems.[409] In conflict with the principle of fiscal autonomy, the Commission would, consequently, be able to interfere with and evaluate the national social, economic or environmental reasons for the imposition of specific taxes. Thus, the AG raised the question whether the alternative, less intrusive methodology of 'general availability' would be more appropriate, where the focus would be shifted back on the most anti-competitive measures, in line with the traditional methodology, which restricts the assessment to differentiations which are not generally available.[410] According to the AG, the three steps of the derogation approach create uncertainty and practical difficulties.[411] Adding thereto, having regard solely to the objective of the tax system (i.e. tax revenue collection) is an arbitrary choice. Often, tax provisions and systems pursue more than one objective at the same time. Giving preference to only one would cause legal uncertainty.[412] Moreover, it is on the part of the Commission to decide which objectives are intrinsic to the system. An asymmetrical treatment could arise in cases where certain objectives are admitted for special taxes but not for general taxes and the other way around (e.g. environmental objectives).[413] However, it should be noted that the AG did not elaborate on how to determine whether a measure is generally available. The fact that a measure is open to any undertaking in a given MS does not reflect the reality that the granting of a measure often depends on the fulfilment of certain conditions.

(b) Finding*: lack of comparability of undertakings (no selective measure)*

Although this case is not a formal or typical tax law case, it nevertheless illustrates very well when companies are not comparable. *Hansestadt Lübeck* concerned an aid investigation by the

[407] Case C-374/17 *A-Brauerei* [2018] ECLI:EU:C:2018:1024, paras 29-33 and 38-43.
[408] Case C-374/17 *A-Brauerei* [2018] ECLI:EU:C:2018:1024, paras 50-52.
[409] Case C-374/17 *A-Brauerei* [2018] ECLI:EU:C:2018:741, Opinion of AG Saugmandsgaard Øe, paras 9 and 73.
[410] Case C-374/17 *A-Brauerei* [2018] ECLI:EU:C:2018:741, Opinion of AG Saugmandsgaard Øe, paras 73-81.
[411] Case C-374/17 *A-Brauerei* [2018] ECLI:EU:C:2018:741, Opinion of AG Saugmandsgaard Øe, para 119.
[412] Case C-374/17 *A-Brauerei* [2018] ECLI:EU:C:2018:741, Opinion of AG Saugmandsgaard Øe, paras 135-136 and 144.
[413] Case C-374/17 *A-Brauerei* [2018] ECLI:EU:C:2018:741, Opinion of AG Saugmandsgaard Øe, paras 149-153.

Commission in respect of various measures concerning Lübeck airport, including the 2006 schedule of charges. The schedule provided for various fees (such as a landing, passenger, and security fee) and applied to all airlines using the airport, unless individual contracts were concluded. The Commission concluded that the advantages established by the schedule were selective as they only benefitted those airlines using Lübeck airport.[414] The applicant countered that the airlines at other airports were not in a comparable factual and legal situation to that of the airlines at Lübeck airport.[415]

The GC emphasised that the restriction of the applicability of the 2006 charges regulation to airlines using Lübeck airport was inherent in the regulation of airport charges in Germany, which foresees that each operator of an airport draws up an individual schedule of charges for that airport. Thus, companies using other German airports are subject to the fee regulations that apply specifically to them, which means that they are not in a situation comparable to that of the users of Lübeck airport. Moreover, it held that the measure at issue did not concern an entire economic sector, which would be the airport sector, but only the companies using Lübeck airport.[416] More importantly, the GC ruled that in order to assess the possible selectivity of a scheme established for the use of specific goods or services in a specific sector with regard to specific undertakings, it is necessary to look in particular at all the undertakings which use or can use those specific goods or services and to verify whether any advantage is or can be granted only to some of them. The situation of the undertakings that do not want to or cannot use the goods or services is irrelevant. Attributing a selective character to a non-discriminatory charging scheme, such as in the present case, would lead to an excessive extension of the concept of aid under Art 107(1) TFEU. Thus, the mere fact that the schedule of charges applied only to airlines using Lübeck airport was not a criterion relevant to the assessment of its selective character.[417] In view of the fact that all airlines could benefit from the charging provisions, the GC denied the existence of selectivity and annulled the contested Commission decision.[418]

The ECJ agreed with the effects-based approach followed by the GC. In this regard, it highlighted the importance of the concept of discrimination within the selectivity assessment.[419] It added that the fact that Lübeck airport was in direct competition with Hamburg airport or

[414] Case T-461/12 *Hansestadt Lübeck v Commission* [2014] ECLI:EU:T:2014:758, paras 1-10 and 47-49.
[415] Case T-461/12 *Hansestadt Lübeck v Commission* [2014] ECLI:EU:T:2014:758, para 48.
[416] Case T-461/12 *Hansestadt Lübeck v Commission* [2014] ECLI:EU:T:2014:758, paras 51-52.
[417] Case T-461/12 *Hansestadt Lübeck v Commission* [2014] ECLI:EU:T:2014:758, paras 53-54.
[418] Case T-461/12 *Hansestadt Lübeck v Commission* [2014] ECLI:EU:T:2014:758, paras 55-60.
[419] Case C-524/14 P *Commission v Hansestadt Lübeck* [2016] ECLI:EU:C:2016:971, paras 48ff.

other German airports and that only airlines using Lübeck airport benefitted from the 2006 schedule was not sufficient to establish selectivity. Instead, in order to find selectivity, the Commission would have to demonstrate that the schedule conferred an advantage on airlines using Lübeck airport to the detriment of those using other airports being, in the light of the objective pursued by that regime, in a comparable factual and legal situation.[420] Consequently, in order to determine the set of undertakings in a comparable factual and legal situation, a reference framework had to be defined, which was considered to be the regime applicable to Lübeck airport alone. Accordingly, the ECJ concluded that the measure did not constitute State aid as the scheme applicable only to airlines operating at Lübeck airport was not selective since the other undertakings were not in a comparable situation in light of the given legal framework. Hence, the GC rightly dismissed the existence of selectivity and the Commission decision.[421]

Also in the *3M Italia* case, the Italian measure was not qualified as State aid. The Italian legislation in question provided for the extinction of pending tax disputes before the Supreme Court of Cassation, which have lasted for more than ten years in total, upon the payment of an amount equivalent to 5% of the value of the claim. The objective of the tax measure was to keep proceedings within a reasonable time as required by Art 6(1) European Convention on Human Rights.[422] The Court held that

> "the fact that only taxpayers satisfying those conditions can benefit from the measure cannot in itself make it into a selective measure. It is clear that persons unable to claim its benefit are not in a comparable factual and legal situation to those taxpayers from the point of view of the national legislature's objective of ensuring compliance with the principle that judgment must be given within a reasonable time."[423]

The same approach was applied again in *ANGED*. In this case, the Spanish legislator introduced a tax on large retail establishments with the purpose to make them responsible for the negative environmental and economic effects of their businesses.[424] The ECJ agreed with the Spanish authority on the fact that the environmental impact of retail establishments is dependent on their size and that, therefore, a condition referring to sales area thresholds is consistent with the environmental objective pursued by the measure.[425] Consequently, different categories of

[420] Case C-524/14 P *Commission v Hansestadt Lübeck* [2016] ECLI:EU:C:2016:971, para 59.
[421] Case C-524/14 P *Commission v Hansestadt Lübeck* [2016] ECLI:EU:C:2016:971, paras 60-66.
[422] Case C-417/10 *3M Italia* [2012] ECLI:EU:C:2012:184, paras 3 and 26.
[423] Case C-417/10 *3M Italia* [2012] ECLI:EU:C:2012:184, paras 42-44.
[424] Case C-234/16 *ANGED* [2018] ECLI:EU:C:2018:281, paras 45.
[425] Case C-234/16 *ANGED* [2018] ECLI:EU:C:2018:281, para 46.

establishment were differentiated, i.e. excluded undertakings (small retail establishments) were not in a comparable situation in light of the objective. The existence of State aid, thus, had to be negated.[426]

The cases *Kernkraftwerke Lippe-Ems* and *UNESA* concerned a tax on the production of nuclear energy and a tax on the production of hydroelectricity respectively. Energy sources and production other than those based on nuclear fuel or inland waters were not taxed.[427] In accordance with the polluter-pays principle, the taxes actually pursued the economic objective of obtaining State revenue to rehabilitate the mining site where radioactive waste is stored and of reducing the tariff deficit of the electricity system. In both cases, the ECJ found that on the one hand, the methods of producing electricity other than that based on nuclear fuel are not in a factual and legal situation that is comparable to that of the production method based on nuclear fuel, as only that method generates radioactive waste. On the other hand, electricity producers other than those using water are not in a comparable factual and legal situation to that of electricity producers using water.[428] Hence, the German and Spanish tax measures were not selective.

3.2.2.3. Benchmark: Objective of What?

Comparability under the second step requires not only a comparison of the legal and factual situation of the undertakings, but also consideration of the objective of the measure or system. Hence, there is a need for a benchmark of comparison. Once a comparable situation has been established, the Court, in principle, moves on to examining the objective of the tax measure. However, the Court unfortunately makes use of this benchmark in an inconsistent manner. It leaves itself some room for interpretation, sometimes resorting to the objective of the individual measure and sometimes to the objective of the system itself. Although the three-step test involves examining objectives at different levels, it is approached from different angles at different levels, albeit sometimes in an incomprehensible manner. In the second step, the assessment is narrow, focusing on the specific measure to examine deviations from the general rule (rather than establishing the general rule). Thus, the second step builds on the first step by zooming in on the specific measures rather than analysing the general framework.

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[426] Case C-234/16 *ANGED* [2018] ECLI:EU:C:2018:281, paras 49-50.
[427] Case C-5/14 *Kernkraftwerke Lippe-Ems* [2015] ECLI:EU:C:2015:354, paras 17-24; Joined Cases C-105/18 to C-113/18 *UNESA* [2019] ECLI:EU:C:2019:935, paras 19-23.
[428] Case C-5/14 *Kernkraftwerke Lippe-Ems* [2015] ECLI:EU:C:2015:354, paras 69-80; Joined Cases C-105/18 to C-113/18 *UNESA* [2019] ECLI:EU:C:2019:935, paras 28ff and 63ff.

In *World Duty Free Group*, the GC explicitly addressed the incoherence on this point.[429] However, on appeal, the ECJ did not give a concrete answer, but instead dismissed the question as irrelevant.[430] The notion of 'system' is very ambiguous and may refer to the aid system or the normal/common system. Sometimes it is not possible or easy to distinguish the objective of the measure from that of the system, of which the measure is part. Nevertheless, at first glance, it appears that the recourse to different terms is only a formal matter of terminology, which is less concerned with the evaluation of the content. This is also clear from the case *Spain v Commission*, where the German, Spanish and Italian versions of the judgement refer to objective of the system and the English version to the objective of the measure.[431] However, it can actually make a big difference whether the general objectives of a system or the specific objectives of a measure are referred to. Moreover, it should be noted that the objectives may be relied upon both at the comparability and the justification stage. Obviously, these two levels serve different purposes, namely, on the one hand, the determination or absence of unequal treatment and, on the other hand, the justification of unequal treatment. In this context, the examination of the second and third stages overlap and displace each other.

The following case examples aim to show the incoherent use of the benchmarks 'objective of the measure', 'objective of the system' and 'objective of the regime'.

(a) Benchmark: *objective of the measure*

A showcase example for the approach based on the objective of the measure is the *Commission v Netherlands* case. The case concerned the notification to the Commission of a Dutch measure establishing an emission trading scheme in order to attain the target of 55 kilotons of nitrogen oxides ($NO_{x)}$ emissions for large industrial facilities, affecting approximately 250 undertakings. The Netherlands intended to lay down an emission standard of NO_x for each industrial facility. Thus, compliance by the undertakings was to be ensured by reducing emissions or by buying emission allowances from other undertakings. Moreover, NO_x credits could be bought, saved or lent for future years. The failure to comply with the imposed standard were sanctioned with a fine. The Commission considered the Dutch measure to be State aid on the basis that the NO_x credits were granted by the State free of charge to a specific group of companies, thereby creating an intangible tradable asset mitigating the companies' normal charges. Nevertheless,

[429] Case T-219/10 RENV *World Duty Free Group v Commission* [2018] ECLI:EU:T:2018:784, para 156.
[430] Case C-51/19 P *World Duty Free Group v Commission* [2021] ECLI:EU:C:2021:793, para 116.
[431] Case C-409/00 *Spain v Commission* [2003] ECR I-1487.

the Commission added that the measure was still compatible with the internal market under Art 107(3) TFEU.[432]

The GC confirmed the existence of an advantage for those undertakings emitting more NO_x than laid down by the standard, thereby avoiding fines by purchasing allowances. In this regard, it corrected the Commission's findings in that it noted that the Netherlands did not directly grant allowances to the undertakings, but authorised them to trade these conferring a market value on those allowances.[433] Concerning selectivity, the GC reiterated that the assessment requires a comparison between the undertakings benefiting from the measure and those in a legal and factual situation that is comparable in light of the objective pursued by the measure in question.[434] The GC found that the measure applied to all large industrial undertakings and facilities with a certain amount of installed total thermal capacity. Hence, the measure was aimed at the biggest polluters and as such in line with the goal of the measure, namely environmental protection. Therefore, it held that the legal and factual situation of those subject to the NO_x standard was not comparable to that of undertakings not subject to that ceiling.[435] The GC added that even in the event that the measure was selective, such a differentiation would arise from the nature and overall structure of the scheme. The ecological considerations would justify a distinction between companies emitting large quantities of NO_x and others, excluding any selectivity.[436]

On appeal, the ECJ repeated that the fact that the number of beneficiaries is very large does not call into question the selectivity of a measure. Additionally, it agreed with the GC that the comparison of the undertakings' situation must be made in light of the objective pursued by the measure in order to assess selectivity.[437] However, in a second step, the Court held that the undertakings concerned enjoyed an advantage over all other undertakings required to observe the NO_x emission requirements, in that only the beneficiaries had the possibility to monetise the economic value of the emission reductions or to avoid fines by purchasing additional allowances.[438] As pointed out by AG Mengozzi, beneficiary and non-beneficiary undertakings

[432] Case T-233/04 *Netherlands v Commission* [2008] ECR II-591, paras 6-20.
[433] Case T-233/04 *Netherlands v Commission* [2008] ECR II-591, paras 70-78.
[434] Case T-233/04 *Netherlands v Commission* [2008] ECR II-591, para 86.
[435] Case T-233/04 *Netherlands v Commission* [2008] ECR II-591, paras 87-90.
[436] Case T-233/04 *Netherlands v Commission* [2008] ECR II-591, paras 94-100.
[437] Case C-279/08 P *Commission v Netherlands* [2011] ECR I-7671, paras 50-52.
[438] Case C-279/08 P *Commission v Netherlands* [2011] ECR I-7671, paras 63-68.

were indeed comparable as the latter could encounter the same difficulties as larger companies in complying with the emissions ceilings.[439] The ECJ continued that

> "Article [107(1) TFEU] does not distinguish between measures of State intervention by reference to their causes or their aims but defines them in relation to their effects. Even if environmental protection constitutes one of the essential objectives of the European [Union], the need to take that objective into account does not justify the exclusion of selective measures from the scope of Article [107(1) TFEU], as account may, in any event, usefully be taken of the environmental objectives when the compatibility of the State aid measure with the common market is being assessed pursuant to Article [107(3) TFEU]".[440]

Applied to the case at hand, the Court ruled, in line with the AG opinion,[441] that a differentiation between companies on the basis of quantitative criteria (total thermal capacity) could not be regarded as inherent to a scheme intended to reduce pollution and could not be justified by ecological considerations. In this regard, the Court put the burden of justification on the MS.[442] Ultimately, it quashed the GC's decision.[443]

(b) Benchmark: *objective of the system*

In *Paint Graphos*, the assessment method of geographic selectivity was confirmed also for the assessment of material selectivity.[444] The Italian legislation in question exempted the income derived by agricultural cooperatives as well as producers' and workers' cooperatives from income tax.[445] In all three cases (C-78/08, C-79/08 and C-80/08), the tax authorities issued notices of assessment adjusting the income of the affected cooperative societies and thereby refusing the tax exemptions. In its selectivity assessment, the Court stated that the selectivity classification requires first the identification of the common or normal tax regime. Secondly, it needs to be determined whether an advantage may be selective by demonstrating a derogation from the common regime "[…] inasmuch as it differentiates between economic operators who, in light of the objective assigned to the tax system of the Member State concerned, are in a

[439] Case C-279/08 P *Commission v Netherlands* [2011] ECR I-7671, Opinion of AG Mengozzi, paras 43-44.
[440] Case C-279/08 P *Commission v Netherlands* [2011] ECR I-7671, para 75.
[441] Case C-279/08 P *Commission v Netherlands* [2011] ECR I-7671, Opinion of AG Mengozzi, para 55.
[442] Case C-279/08 P *Commission v Netherlands* [2011] ECR I-7671, paras 76-79.
[443] Case C-279/08 P *Commission v Netherlands* [2011] ECR I-7671, para 115.
[444] Joined Cases C-78/08 to 80/08 *Paint Graphos* [2011] ECR I-7611, para 49, referring to Case C-88/03 *Portugal v Commission* [2006] ECR I-7115.
[445] Joined Cases C-78/08 to C-80/08 *Paint Graphos* [2011] ECR I-7611, para 6.

comparable factual and legal situation […]".[446] Thus, the objective of the reference system was to assess the existence of discriminatory treatment between economic operators. In this respect, the Court held that the corporate tax system must be regarded as the legal regime of reference since the tax benefit for cooperative societies represented a derogation from it. The benefit was not available to all economic operators but depended on the legal form of the company. Moreover, the Court argued that cooperative societies conform to particular operating principles distinguishing them from other operators.[447] In the light of these characteristics, according to the Court, cooperative societies cannot be regarded as being in a comparable factual and legal situation to that of commercial companies but ultimately left this observation to the referring court.[448] As regards the last step, the justification analysis, it held that the objective pursued by the measure is not sufficient for an outright justification. What really counts are the effects of it. A distinction must be made between objectives, which are extrinsic to the tax regime and those, which are inherent. It is also necessary to ensure that the tax benefits are consistent with the principle of proportionality and do not go beyond what is necessary, in that the legitimate objective being pursued could not be attained by less far-reaching measures.[449] In the end, the Court left the decision of a finding of State aid to the national court.

Interestingly, *Paint Graphos* was decided on the same day as *Commission v Netherlands*. In the former, the Court had regard to the objective of the system, whereas in the latter, it looked at the objective of the measure.

(c) Benchmark: *objective of the regime*

Although this case does not concern a tax measure per se, the author finds it particularly significant and illustrative to show the different terms that are used by the Court. Because of this significance, the case is nevertheless dealt with, as the result can be transferred one-to-one to 'classic' tax measures. The *Eventech* case concerned the lawfulness of a policy permitting black cabs (ordinary London taxis) to use bus lanes in London in the peak periods, while prohibiting minicabs (private hire vehicles) to do so other than for the picking up and dropping off of passengers who have pre-booked minicabs. In London, taxi services are provided by both black cabs and minicabs. The services, however, are licensed under different statutory provisions stipulating different conditions. Black cabs are licensed according to the London Cab Order 1934, allowing them to ply for hire, i.e. collecting passengers from the street without

[446] Joined Cases C-78/08 to C-80/08 *Paint Graphos* [2011] ECR I-7611, para 49.
[447] Joined Cases C-78/08 to C-80/08 *Paint Graphos* [2011] ECR I-7611, paras 50-55.
[448] Joined Cases C-78/08 to C-80/08 *Paint Graphos* [2011] ECR I-7611, paras 61-63.
[449] Joined Cases C-78/08 to C-80/08 *Paint Graphos* [2011] ECR I-7611, paras 67-69 and 75.

prior booking. On the contrary, minicabs are licensed under the Private Hire Vehicles (London) Act 1998, which only allows the use of bus lanes for the purpose of loading and unloading. Moreover, they are not permitted to ply for hire, but only chauffeur passengers that have pre-booked their services. Further, black cabs are subject to the requirement of compellability (time and distance obligation towards the passenger), certain conditions of fitness (vehicle shape, size and taxi sign), a strict regulation of fares (taxi meter) and a topographical test (knowledge of London). There are no similar requirements for minicabs.[450] The responsible traffic authorities may issue penalty charge notices for breaches of the above-mentioned obligations and prohibitions.[451] In the case at hand, the company Eventech operated minicabs in London. It was fined for the illicit use of the London bus lanes. Subsequently, Eventech brought proceedings and claimed that the policy conferred an economic advantage on the operators of black cabs, constituting unlawful State aid.[452] The referring court decided to stay proceedings and refer preliminary questions to the ECJ on, amongst others, the selectivity of the policy. It is interesting to note that the referring court explicitly asked the ECJ what the relevant objective is by reference to which the comparable factual and legal situation is assessed.[453]

The ECJ emphasised that the issue at hand did not so much concern the imputability to State resources, but rather the existence of an economic advantage. In this regard, it noted that the right to use bus lanes was a privileged access right for undertakings providing taxi services with an economic value and the objective to ensure a safe and efficient transport system.[454] Moreover, the Court held that the realisation of this objective could be jeopardised if black cabs were charged for accessing bus lanes and that the "national authorities could reasonably take the view that the access of those taxis to bus lanes is liable to enhance the efficiency of the London road transport system and that […] [the right of access] is liable to achieve the realisation of the objective concerned."[455] Nevertheless, it must be determined whether the criteria for granting the right of access is applied in a non-discriminatory manner to the economic operators by comparing the factual and legal situation of them in light of the objective pursued by the regime.[456] Here, the Court ruled that the situation could not be limited to the pre-booking sector, but must also take into account the ply for hire market. Following the

450 Case C-518/13 *Eventech* [2015] ECLI:EU:C:2015:9, paras 2-11.
451 Case C-518/13 *Eventech* [2015] ECLI:EU:C:2015:9, paras 12-19.
452 Case C-518/13 *Eventech* [2015] ECLI:EU:C:2015:9, paras 20-26.
453 Case C-518/13 *Eventech* [2015] ECLI:EU:C:2015:9, para 30.
454 Case C-518/13 *Eventech* [2015] ECLI:EU:C:2015:9, paras 47-50; see also Case C-518/13 *Eventech* [2015] ECLI:EU:C:2014:2239, Opinion of AG Wahl, paras 35-47.
455 Case C-518/13 *Eventech* [2015] ECLI:EU:C:2015:9, paras 51-52.
456 Case C-518/13 *Eventech* [2015] ECLI:EU:C:2015:9, paras 53-55.

various requirements and obligations that black cabs have to meet, they could not be considered to be in a factual and legal situation comparable to that of minicabs. Thus, the measure at hand was not selective.[457]

3.2.2.4. Preliminary Findings for the Second Step

To date, neither the Commission nor the CJEU have issued guidelines on how the reference system should be structured and which features must be taken into account. The most recent judgements, in particular the rulings on advance tax rulings, indicate that the reference system must consist of national law. However, this does not prevent either the Commission or the CJEU from interpreting and assessing national law when carrying out the selectivity test. For this reason alone, the test must be adapted. Obviously, this also makes it more difficult and sometimes impossible to identify a derogation from the normal system in the next step. Sometimes the system itself is categorised as selective.

The classification as a general measure is a rather relative concept, as this largely depends on the yardsticks chosen for the comparison. If a measure favours only certain economic sectors or undertakings, it is considered selective. However, even if a measure affects an entire sector of the economy, it may be selective. Moreover, a scheme that is open to all domestic companies investing abroad is not a general measure.[458] According to the Court, the number of beneficiary undertakings or the absence of competition between them and other companies are not sufficient indicators of the existence of a general measure, no matter how objective the criteria may appear to be. What is decisive is the effect of a measure. On the contrary, the ECJ rather evaluates whether the undertakings concerned have made use of a certain choice of transactions. It is clear that the effect is that companies that choose to carry out a transaction, as opposed to those that do not, are in a different (better) position. This is a natural consequence and should not lead to measures that are basically open to all being classified as selective. The question arises here as to why there is then a differentiation between general and selective measures at all. There is no clear delimitation between these two types of measures and the case law does not provide any useful guidance.

In his observations in *A-Brauerei*, AG Saugmandsgaard Øe was right to consider that such a broad understanding of the State aid rules (including general rules open to all) would lead to almost all decisions on national tax policy being called into question. However, the ‘general

[457] Case C-518/13 *Eventech* [2015] ECLI:EU:C:2015:9, paras 59-61; see also Case C-518/13 *Eventech* [2015] ECLI:EU:C:2014:2239, Opinion of AG Wahl, paras 64-75.
[458] Olivier Peiffert, ‘Comparaison n’est pas raison: Pour une clarification du critère de sélectivité d’une aide d’État’ (2017) 3 Concurrences 52, 58.

availability' approach proposed by the AG makes little sense in that it is not clear what this approach should look like or when a measure is considered to be generally available. It is already unclear how a distinction should be made between general and selective measures. Simply saying that a measure is generally available does not really solve the problem, it just gives it a different name. In order to determine whether discrimination exists in a specific case, a case-by-case examination is required in any case.

The introduction of tax differentiation is necessary and useful to create different incentives, such as the obvious example of environmental protection. A differentiation introduced by a measure must be consistent with its objective. However, the approach of taking into account the objective of the measure has evolved into a method taking into account the objective of the reference framework, which is clearly delineated from the measure itself.[459] In the end, the alternating reference to 'measure', 'system' or 'regime' does not seem to have too much impact on the outcome of a case, as the objective is re-examined again in the final step of the three-step test, the justification analysis. Although this appears to be merely a matter of terminology by the Court, it is not irrelevant whether the objective of the measure or of the system is taken as the starting point. This objective can be different. In order to prove selectivity prima facie, it makes sense to focus on the objective of the measure. At the justification level, on the other hand, it makes sense to focus on the objective of the system, as this is where the logic and nature of the system are analysed anyway.

The reasoning put forward by the ECJ in *Gibraltar*, namely that selectivity does not simply result from a different tax burden but from the establishment of a privileged category, seems to be a more plausible solution. Although the GC addressed this point of reference in subsequent judgements, the ECJ overturned its own reasoning shortly afterwards. This shows all the more that the GC and the ECJ do not agree on selectivity. It would be desirable for the CJEU as an institution to commit itself to a clear line, as it does with the fundamental freedoms.

The second step is very similar to the non-discrimination test known from the fundamental freedoms. By comparing two situations that are both factually and legally similar, the aim is to find out whether one of these situations is unjustifiably treated less favourably, based on the objective of the measure. In other words, it is examined whether certain companies are discriminated against by being treated differently from companies in a comparable situation because they are denied or not offered access to favourable treatment. The Court has already

[459] See Nicolas Martinez, 'Sélectivité en matière fiscale: Une analyse généalogique de la méthode en trois étapes' (2019) 55(2) Cahiers de droit européen 485, 510.

partially attempted to incorporate the principle of non-discrimination into its legal assessment. The three-step method adopted by the Commission and applied by the Court was initially not based on the principle of equal treatment. That principle was introduced by the CJEU only at a later stage by requiring comparability of undertakings and situations. Accordingly, a simple derogation from the reference system is no longer sufficient. However, it can be seen from the preceding case examples that the Court rarely makes clear reference to the principle of non-discrimination and equal treatment. Therefore, the reference thereto should be consolidated much more clearly in the case law on State aids. As will be shown in Chapter 4, a much more holistic approach is taken in the context of the fundamental freedoms by using the non-discrimination test. Although a comparator pair is also required here, the artificial creation of a framework of reference and a deviation from it are ruled out. Chapter 5 takes a closer look at what such a methodology could look like for Art 107(1) TFEU.

Under no circumstances can the methodology function without a level of justification, which is why this is now explained as the last step of the test.

3.2.3. Third Step: Justification of the Derogation

The deviation from the reference system, and so the existence of a prima facie selective measure, will have to be justified for its compatibility with EU State aid rules in the next step. The concept of justification was first introduced in the *Italian Textile* case.[460] The Court provided for the possibility of justification by the nature or economy of the system, which subsequently became the third step of the method. In its 1998 Notice, the Commission introduced a distinction between external and internal objectives. Accordingly, the justification grounds are limited and must be intrinsic to the system, i.e. the measure is necessary for the system's functioning and effectiveness (economic reasons). Examples of such internal objectives are the fight against tax evasion and fraud, the principle of tax neutrality, the avoidance of double taxation or the administrative manageability.[461] External policies and objectives, which are not inherent to the system, are not accepted. These include social as well as economic reasons, such as regional development, social cohesion policy or the preservation of employment.[462] In the 2016 Notice, the Commission reinforced the distinction previously

[460] Case C-173/*73 Italy v Commission* [1974] ECR 709, para 33.
[461] Commission, 'Notice on the application of the State aid rules to measures relating to direct business taxation' OJ C384/3, 10 December 1998, paras 23ff; 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' OJ C262, 19 July 2016, paras 138-139; Roland Ismer and Sophia Piotrowski, 'The Selectivity of Tax Measures: A Tale of Two Consistencies' (2015) 43 Intertax 559, 565.
[462] Commission, 'Notice on the application of the State aid rules to measures relating to direct business taxation' OJ C384/3, 10 December 1998, para 26; Commission, 'Notice on the notion of State aid as referred to in Article

made and provides for a non-exhaustive list of possible justification grounds.[463] Remarkably, the burden of proof for the justification of a measure lies with the MS.[464] The Court adopted the Commission's qualification:[465] The more recent case law of the Court refers either to the justification of the nature or general scheme of the system or to the justification by the inner logic of the system. These expressions can be viewed as synonyms. Thus, once a derogation of the reference system has been established (prima facie selectivity), it must be assessed whether the derogation can be justified on the basis of the nature and general scheme of the tax system. On top, the Court has added a hurdle for the MS in demanding that the logic of the system undergoes a proportionality test. As a consequence, a derogation may only be justified if it does not go beyond what is necessary to achieve the legitimate objective and could not have been achieved by less far-reaching measures.[466]

With regard to the tax authorities' discretion in the application of the tax regime in question, the Court held that justification is possible if the degree of latitude is limited to verifying the conditions, in line with the tax objective, and if the criteria to be applied are inherent in the nature of the tax regime. In other words, justification is not possible if the tax authorities have discretion to determine the beneficiaries or the conditions for eligibility. The application of an authorisation system will not be considered selective if the authorities have only a degree of latitude limited by objective criteria related to the tax system.[467]

The extent to which the Court carries out the justification test and which objectives are permissible or impermissible is shown by the following examples, some of which have been discussed previously. It will become clear that the Court takes a rather strict approach to justification. However, the distinction between valid reasons for maintaining the tax base and all other extrinsic reasons is not clear-cut.

107(1) of the Treaty on the Functioning of the European Union' OJ C262, 19 July 2016, paras 135 and 138; see also Case C-88/03 *Portugal v Commission* [2006] ECR I-7115, para 82; Case C-6/12 *P* [2013] ECLI:EU:C:2013:525, para 30.

[463] 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' OJ C262, 19 July 2016, paras 138ff.

[464] Case C-159/01 *Netherlands v Commission* [2004] ECR I-4461, para 43; Case C-159/01 *Netherlands v Commission* [2004] ECR I-4461, Opinion of AG Léger, para 63; Joined Cases T-129/07 and T-130/07 *Ireland v Commission* [2019] ECLI:EU:T:2019:610, para 60.

[465] See eg C-88/03 *Portugal v Commission* [2006] ECR I-7115, para 81; Joined Cases C-78/08 to C-80/08 *Paint Graphos* [2011] ECR I-7611, para 69; Case C-374/17 *A-Brauerei* [2018] ECLI:EU:C:2018:1024, para 48.

[466] Joined Cases C-78/08 to C-80/08 *Paint Graphos* [2011] ECR I-7611, para 75; 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' OJ C262, 19 July 2016, para 140.

[467] Case C-6/12 *P* [2013] ECLI:EU:C:2013:525, paras 24-27.

(a) Finding: *the measure is not justified on environmental grounds*

Adria-Wien Pipeline, as mentioned before, involved a preliminary ruling referred by the Austrian Constitutional Court on energy tax rebates. The main question was whether the supply of energy on preferential terms to undertakings producing goods constituted selective aid. After examining the comparability of the undertakings, the Court concluded that there was a selective, discriminatory treatment. As a next step, the Court performed the analysis of justification by the nature or general scheme of the system. Although the Court held that, in principle, environmental protection requirements are capable of justifying such measure, neither the ecological considerations nor the large number of eligible undertakings provided grounds for concluding that the initiative was a general measure of economic policy. Rather, the Court ruled that the intention of the measure was (as rightly found by the Commission) the preservation of the competitiveness of the manufacturing sector.[468] Hence, the measure could not be justified on grounds of environmental protection.

(b) Finding: *the measure is justified on environmental grounds*, appeal: *it is not justified*

The *British Aggregates* case dealt with the imposition of a levy on aggregates. The Commission argued in its decision that the levy was justified by the nature and general scheme of the system. On the one hand, the levy aimed at the reduction of non-renewable resources and the negative environmental impact. On the other hand, the exemption for export activities was equally classified as justification on the grounds of legal certainty to aggregate exporters and the avoidance of unequal treatment of aggregate exports otherwise eligible for exemption.[469] The GC agreed with the Commission by determining that the levy at issue was justified by the nature and general scheme of the measure, in particular by favouring the replacement of environmental-unfriendly aggregates by recycled products or those materials not covered.[470] Both, the Commission and the GC referred to the measure as an indirect tax levied on products and not on undertakings.[471] It thus upheld the Commission decision and the finding of justified State aid.

The ECJ did not agree with the Commission and the GC on appeal. The ECJ argued that the need to take account of requirements relating to environmental protection could not justify the exclusion of selective measures from the scope of Art 107(1) TFEU, regardless of the

[468] Case C-143/99 *Adria-Wien Pipeline* [2001] ECR I-8365, paras 31, 48 and 52-54.
[469] Case T-210/02 RENV *British Aggregates v Commission* [2006] ECR II-2789, paras 3-25.
[470] Case T-210/02 RENV *British Aggregates v Commission* [2006] ECR II-2789, paras 134-137.
[471] Case T-210/02 RENV *British Aggregates v Commission* [2006] ECR II-2789, para 150.

specificity of the levy.[472] As a consequence, the ECJ quashed the decision and referred the case back to the GC. In its renvoi decision, the GC accordingly held that the Commission and the UK failed to prove that the harmful nature of the extraction of the untaxed materials differs from that of the taxed materials. It was concluded that the tax differentiation between these aggregates was a derogation from normal taxation and gave rise to a selective advantage.[473]

The Court took a similar view in *Commission v Netherlands*, in which it ruled that while environmental protection is an essential objective of the EU, the measure in question, a NO_x emissions trading scheme, cannot be justified on ecological grounds because it selectively differentiates between companies.[474]

(c) Finding: *the measure is justified to counter VAT loss and maintain a proper system of insurance tax*

The preliminary ruling reference in *GIL Insurance* concerned a UK tax on insurance premiums (IPT). The generally applicable standard tax rate was set at 4%, whereas a higher rate of 17.5% applied to insurance premiums relating to domestic appliances, motor cars and travel in order to prevent value added tax (VAT) revenue loss from value-shifting. Concerning for example domestic appliances, the higher rate only applied where the supplier was connected with the insurer, where the supplier arranged the insurance, or where the supplier received a commission on the provision of insurance. Thus, insurance sold directly by insurance companies or brokers were subject to the standard rate.[475] The applicants, insurance companies and insurance intermediaries, all paid the higher IPT rate for insurance sold in connection with the sale or rental of domestic appliances. The applicants maintained that the higher rate constituted State aid and demanded reimbursement.[476]

AG Geelhoed and the ECJ held that the IPT was not a general tax on consumption, i.e. no turnover tax. Neither did they regard it as being part of the VAT system since it was not charged at each stage of the production and distribution process, but only on the insurance premium on conclusion of the insurance contract.[477] The Court went on to examine the existence of State aid and ruled that it must "be determined whether, under a particularly statutory scheme, a State measure is such as to favour 'certain undertakings or the production of certain goods' in

[472] Case C-487/06 P *British Aggregates v Commission* [2008] ECR I-10515, para 92.
[473] Case T-210/02 RENV *British Aggregates v Commission* [2012] ECLI:EU:T:2012:110, paras 74-79 and 87-88.
[474] Case C-279/08 P *Commission v Netherlands* [2011] ECR I-7671, paras 75-79.
[475] Case C-308/01 *GIL Insurance and Others* [2004] ECR I-4777, paras 7-17.
[476] Case C-308/01 *GIL Insurance and Others* [2004] ECR I-4777, paras 18-22.
[477] Case C-308/01 *GIL Insurance and Others* [2004] ECR I-4777, paras 35-37 and 44-47; Case C-308/01 *GIL Insurance and Others* [2004] ECR I-4777, Opinion of AG Geelhoed, paras 42-45.

comparison with others which, in light of the objective pursued by the system in question are in a comparable legal and factual situation".[478] In this respect, the Court noted that the IPT was intended as a general tax measure and thus in principle applicable to all insurance contracts. It subsequently examined whether the distinguishing criterion could be justified by the nature or general scheme of the system. The Court recalled that the objective of the IPT was to counteract the taking advantage of the difference between the standard rate and VAT by price manipulation, which gave rise to VAT loss. Thus, the higher IPT rate was not intended to benefit operators subject to the standard rate.[479] As a result, in light of the objective of the system, namely making classic service contracts liable to VAT and increase direct insurance for ancillary insurance contracts, the specific tax measure introduced by the UK did not constitute State aid, but was justified by the nature and general scheme of the national system of insurance taxes.[480]

3.2.3.1. Preliminary Findings for the Third Step

The case law of the Court demonstrates that the distinction between justified reasons and unjustified reasons is not a simple one. The broader the reference framework determined (first step), the more likely it is that the objective referred to under the comparability approach (second step) is confused with general objectives of a tax (third step). The clear distinction between the second and third step can thus be diluted and both steps may overlap. As shown, the principles and objectives of the type of tax in question already play a role in the delimitation of the system of reference and in the question of an unobjective deviation from the system.[481] As briefly mentioned above, it makes sense to limit the second step to the objective of the measure and the third step to the objective of the system. As such, the third step, conceived as a justification test, misses the very purpose of the selectivity test as a whole, which is to establish (or deny) selectivity and not to justify its existence. This also means that the burden of proof is shifted to the MS and no longer lies with the Commission. Instead, the Commission should have to explain why the objective of the tax system in question does not permit the particular (prima facie selective) measure or is incompatible with it.

This interpretation harbours the aforementioned risk that the Commission and the Court will find their way into national law. This is seen by many States as an encroachment on tax

[478] Case C-308/01 *GIL Insurance and Others* [2004] ECR I-4777, para 68.
[479] Case C-308/01 *GIL Insurance and Others* [2004] ECR I-4777, paras 70-76.
[480] Case C-308/01 *GIL Insurance and Others* [2004] ECR I-4777, para 78; Case C-308/01 *GIL Insurance and Others* [2004] ECR I-4777, Opinion of AG Geelhoed, paras 81-88.
[481] Cf Thomas Jaeger, 'Steuerliche Maßnahmen' in Franz Jürgen Säcker, Ulrich Karpenstein and Markus Ludwigs (eds), *Münchener Kommentar zum Wettbewerbsrecht Band 5: Beihilfenrecht* (4th edn, Beck 2022) paras 63-65.

autonomy, which was a central point in the decisions on tax rulings. As these belong to a special category of tax measures, they will now be dealt with separately on the subject of selectivity.

3.3. The Special Case of Tax Rulings[482]

Without nations offering preferential tax regimes at the outset, international BEPS conceived by MNEs would be fruitless. A striking illustration of such tax competition is the LuxLeaks tax scandal, in which documents were leaked exposing favourable tax arrangements offered by Luxembourg to some of the world's largest companies. The Luxembourg tax authorities granted advance tax rulings on a large scale, resulting in a drastic reduction of the corporate income tax for the companies concerned. In most cases, the Luxembourg subsidiaries were handling hundreds of millions of euros, but maintaining and conducting little or no presence and economic activity there.[483] Scandals such as LuxLeaks have contributed to the acceleration of the Commission's State aid inquiries and to a greater attention to the phenomenon of selective fiscal measures.

Examples of this phenomenon are tax rulings rendered by national authorities and lately being subject to the scrutiny of the Court. Tax rulings as such are not problematic: They are comfort letters by tax authorities providing businesses with legal certainty on how their corporate tax will be calculated.[484] Nevertheless, they may involve State aid within the context of EU law if they provide a selective advantage. The reason why transfer pricing has increasingly been dragged into the spotlight is because groups have certain discretion in determining how to allocate expenses and returns to their subsidiaries and permanent establishments located in different places. Hence, the occurrence of the phenomenon of profit shifting is not uncommon at this stage when higher costs are allocated to the company with the higher tax rate and higher revenue is allocated to the company with the lowest income tax.[485] So far, the internationally adopted non-binding standard for the allocation of taxable income between associated

[482] This chapter partly draws on findings from the author's master thesis, see Daniela Gschwindt, 'Digital business and permanent establishment: a case study on Amazon and the solution pursued by BEPS' (Universität Wien 2018) and the author's contribution, see Daniela Gschwindt, 'The dynamics of selectivity in tax ruling cases' (2024) EU Law Live.

[483] European Parliament, 'Special Report on tax rulings and other measures similar in nature or effect (2015/2066(INI))' (5 November 2015) <https://www.europarl.europa.eu/doceo/document/A-8-2015-0317_EN.html?redirect> accessed 15 September 2024; Douglas Dalby, 'Luxembourg falls further behind EU AML rules as companies fail to disclose ownership' (ICIJ, 12 September 2019) <https://www.icij.org/investigations/luxembourg-leaks/luxembourg-falls-further-behind-eu-aml-rules-as-companies-fail-to-disclose-ownership/> accessed 17 September 2024.

[484] Carlo Romano, *Advance Tax Rulings and Principles of Law: Towards a European Tax Rulings System?* (IBFD 2002) 485; Franklin Cachia, 'Analysing the European Commission's Final Decisions on Apple, Starbucks, Amazon and Fiat Finance & Trade' (2017) EC Tax Review 23, 23.

[485] Michael Lang and others, *Fundamentals of Transfer Pricing: A Practical Guide* (Kluwer Law International 2018) 3-4.

undertakings is the ALP as set out in the OECD Model Tax Convention (MTC).[486] In the case of tax rulings and more specifically APAs, the principal concern is the method chosen to calculate the transfer pricing arrangements between related undertakings.

3.3.1. The Arm's Length Principle in Transfer Pricing

More and more cases controlled by the Commission deal with individual tax rulings and APAs. Tax rulings refer to a procedure under which, in advance of entering into transactions, taxpayers may obtain a formal confirmation of the tax consequences from the national tax authorities.[487] It is a collective term used for all kinds of tax arrangements between the authority and the taxpayer. Investors often require advance rulings to forecast the prospective tax burden of future business activities.[488] APAs are agreements between the tax administration and the taxpayer with the purpose of defining the transfer pricing method applied to determine the ALP in controlled transactions.[489] APAs, and tax rulings in general, have an important function: They provide certainty for taxpayers on the determination of the ALP and value of a transaction before entering into such. However, they become problematic when used as instruments for aggressive tax planning and tax avoidance schemes. Tax rulings do not constitute aid if they are mere interpretations and applications of tax rules based on objective criteria. If the authority however exercises discretionary powers that go beyond the simple administration of tax revenues, a measure may be selective.[490]

In order to determine the correct application of the transfer pricing rules and the transaction price, a number of criteria are considered under the ALP. Thus, the APA determines whether the transaction price between related parties within a group is at arm's length compared to the transaction price with a non-related party. The most prominent source of the ALP is Art 9 OECD MTC, which provides that the conditions of transactions between enterprises belonging to the same MNE group (controlled transactions) should not be different from what they would

[486] OECD, 'Model Tax Convention on Income and on Capital: Condensed Version 2017' (2017) Art 9(2) <https://www.oecd.org/en/publications/model-tax-convention-on-income-and-on-capital-condensed-version-2017_mtc_cond-2017-en.html> accessed 18 September 2024; the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022 serve as a guidance for the interpretation and application of Art 9 OECD MTC.
[487] Julie Rogers-Glabush, *IBFD International Tax Glossary* (7th edn, IBFD 2015) 9.
[488] Markus Diller and others, 'Boon or Bane? Advance Tax Rulings as a Measure to Mitigate Tax Uncertainty and Foster Investment' (2017) 26 European Accounting Review 441, 443.
[489] Julie Rogers-Glabush, *IBFD International Tax Glossary* (7th edn, IBFD 2015) 9; European Parliament, ''Tax Rulings' in the EU Member States' (Study for the ECON Committee 2015) 26 <https://www.europarl.europa.eu/RegData/etudes/IDAN/2015/563447/IPOL_IDA(2015)563447_EN.pdf> accessed 18 September 2024.
[490] Franklin Cachia, 'Analysing the European Commission's Final Decisions on Apple, Starbucks, Amazon and Fiat Finance & Trade' (2017) EC Tax Review 23, 27; see also 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' OJ C262, 19 July 2016, paras 169-174.

be if the parties were independent (uncontrolled transactions). Uncontrolled transactions are to be subject to the full play of market forces in order to be considered at arm's length. In other words, transfer prices should not be manipulated to artificially shift profits out of the country, but rather bring equal treatment between related and unrelated transactions. The OECD Transfer Pricing Guidelines provide guidance and a more harmonised proceeding for the interpretation and application of Art 9 OECD MTC.[491] They recognise five different transfer pricing methods to establish whether transactions are in line with the ALP. The traditional transaction methods include the Comparable Uncontrolled Method (CUP), the Resale Price Method (RPM) and the Cost Plus Method (CPLM). The remaining transactional profit methods embrace the Profit Split Method (PSM) and the Transactional Net Margin Method (TNMM). The choice of method should always be oriented towards the most appropriate one for the case at hand based on factors such as the type of transaction in question or the behaviour on the market.[492] Tax administrations have the competence to adjust or re-categorise the transaction in case it does not reflect its real nature.[493]

Although many countries have agreed on the ALP as international transfer pricing standard and have included the OECD provision in their domestic legal system, it is not a binding instrument. What has recently caused a lot of uproar is that the Commission has assumed in its decisions on some tax rulings that Art 107 TFEU contains an independent European ALP. This will now be analysed in more detail.

3.3.2. The Commission's Reference System: The Arm's Length Principle as Inherent Part of Art 107 TFEU

With the start of its inquiry in 2013, the Directorate General Competition looked at more than thousand tax rulings from an EU State aid perspective.[494] The Commission called into question all of these agreements concluded by undertakings, which were relying on them to compute and plan the amount of their corporate income tax. Some of the Commission's decisions dealing with profit allocation include the following cases: Amazon transferring profits among its

491 OECD, 'Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022' (2022) <https://www.oecd.org/en/publications/oecd-transfer-pricing-guidelines-for-multinational-enterprises-and-tax-administrations-2022_0e655865-en.html> accessed 17 September 2024, 31ff.

492 OECD, 'Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022' (2022) <https://www.oecd.org/en/publications/oecd-transfer-pricing-guidelines-for-multinational-enterprises-and-tax-administrations-2022_0e655865-en.html> accessed 17 September 2024, 93ff.

493 Art 9(2) OECD MTC.

494 Commission, 'DG Competition Working Paper on State Aid and Tax Rulings' (2016) <https://competition-policy.ec.europa.eu/document/download/cc11b513-0d4b-4617-bbb2-9c8a7cdb59c5_en?filename=specific_aid_instruments_working_paper_tax_rulings.pdf2> accessed 17 September 2024.

subsidiaries, Apple shifting its income from the US to Ireland, Fiat extending an intercompany loan to its subsidiaries and Starbucks using intercompany transfer pricing. Although the cases were investigated for differing factual reasons, they all revolve around the criterion of selectivity, in particular the definition of the reference system.

In these tax rulings, the Commission identified the general corporate income tax system as the reference system. Resulting therefrom, the Commission's definition of the reference system includes both integrated (group companies) and non-integrated companies (stand-alone companies). In its assessment, the Commission compares the treatment of the recipient of the ruling with that of a non-integrated company. In doing so, it assumes the taxable income of non-integrated companies to be at arm's length, i.e. they enter into transactions with unrelated parties always reflecting market terms.[495] The Commission believes that intra-group transactions of integrated companies should be priced on market terms to ensure an equal treatment between them and non-integrated companies on the basis of Art 107(1) TFEU.[496]

The Commission derives the ALP directly from primary law. It consistently held and even reiterated in its 2016 Notice that

> "[t]his arm's length principle necessarily forms part of the Commission's assessment of tax measures granted to group companies under Article 107(1) of the Treaty, independently of whether a Member State has incorporated this principle into its national legal system and in what form. […] A tax ruling endorsing such a methodology ensures that that company is not treated favourably under the ordinary rules of corporate taxation of profits in the Member State concerned as compared to standalone companies who are taxed on their accounting profit, which reflects prices determined on the market negotiated at arm's length. The arm's length principle the Commission applies in assessing transfer pricing rulings under the State aid rules is therefore an application of Article 107(1) of the Treaty, which prohibits unequal treatment in taxation of undertakings in a similar factual and legal situation. This principle binds the Member States and the national tax rules are not excluded from its scope."[497]

[495] See eg *Fiat* (SA.38375) Commission Decision 2016/2326 [2015] OJ L351, paras 197-209.
[496] See eg *Fiat* (SA.38375) Commission Decision 2016/2326 [2015] OJ L351, paras 226-228.
[497] 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' OJ C262, 19 July 2016, para 172; see Joined Cases C-182/03 and C-217/03 *Belgium and Forum 187 v Commission* [2006] ECR I-5479, para 81; see also Case T-538/11 *Belgium v Commission* [2015] ECLI:EU:T:2015:188, paras 65ff and the case law cited.

Regarding the level of comparison, the Commission believes that

> "[…] the assessment of whether that ruling gives rise to an advantage should be made by the Member State in question, namely [the financing company] and Luxembourg, and should not take into account a possible neutral impact of the measure at the level of other [affiliates of the Luxembourg financing company] as a result of their treatment by other Member States […]."[498]

Hence, the Commission argues that only the tax treatment of the undertaking receiving the ruling should be taken into account, regardless of associated undertakings in other MS. In other words, the comparison between integrated and non-integrated companies is to be carried out solely at the level of the individual group company and the MS where it resides.[499] In the Commission's view, equal treatment must be applied on a country-specific basis.

Yet, the economic differences between group companies and stand-alone companies should be taken into account for the assessment of comparability. The prices for transactions of integrated companies are estimates based on the group, not on the market.[500] Thus, two legal entities in two different factual situations are treated the same way. Moreover, the Commission has not identified the national transfer pricing rules codifying the ALP as reference system. If it had done so, the undertakings concerned would have merely consisted of integrated companies. In that case, the issue of equal treatment would have implied a comparison between the tax treatment of the integrated company pursuant to the ruling and the treatment of other integrated companies under the national transfer pricing rules. Hence, by limiting the assessment under Art 107(1) TFEU, the Commission is ignoring part of the legal framework applicable in the MS. As a result, so far, the Commission has always found that the tax rulings have resulted in a favourable treatment of the integrated companies compared to the hypothetical non-integrated companies.[501] It should be noted that in the *Amazon*, *Fiat* and *Starbucks* cases, the Commission did not set out what the correct application of the law would have been, but merely expressed

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[498] See eg *Fiat* (SA.38375) Commission Decision 2016/2326 [2015] OJ L351, para 313.

[499] Steven Verschuur and Melina Stroungi, 'State Aid and Tax Rulings – the Commission's Approach to Virtual Payments: Equal Treatment of Multinationals?' (2017) EStAL 598, 603.

[500] Raymond Luja, 'State Aid Benchmarking and Tax Rulings: Can We Keep It Simple?' in Isabelle Richelle, Wolfgang Schön and Edoardo Traversa (eds), *State Aid Law and Business Taxation* (2016 Springer) 114ff; Steven Verschuur and Melina Stroungi, 'State Aid and Tax Rulings – the Commission's Approach to Virtual Payments: Equal Treatment of Multinationals?' (2017) EStAL 598, 601.

[501] See *Fiat* (SA.38375) Commission Decision 2016/2326 [2015] OJ L351; *Starbucks* (SA.38374) Commission Decision 2017/502 [2015] OJ L83.

doubts as to whether the national law was correctly applied in the respective cases, thereby reversing the burden of proof.[502]

Moreover, on the one side, the Commission relies on the OECD Transfer Pricing Guidelines for the assessment of adequateness of the methodological choice of the transfer pricing method. On the other side, the Commission clearly emancipates its own arm's length standard from that of the OECD.[503] Neither Art 107 TFEU nor any other source of EU law explicitly provides for an ALP. There is not even a requirement for any transfer pricing legislation.[504] It is questionable whether there is only one correct method of transfer pricing adjustment that follows a (controversial) (international) standard endorsed by the Commission. Especially in scenarios where two jurisdictions have agreed on one approach to allocate the profits of an undertaking operating in both countries, it seems odd to impose a different standard set by the Commission.[505] It is therefore not surprising that recent CJEU rulings, in particular *Fiat*, (at least in part) contradict the Commission.

3.3.3. The Approach and Findings of the CJEU: Notorious Discrepancy between GC and ECJ

The first ECJ decision dealing with the State aid assessment of tax rulings was *Forum 187*. The case concerned the Belgian tax regime for coordination centres. To benefit from the regime, a centre was required to obtain an individual authorisation by royal decree. According to the Commission, the regime derogated from the ordinary tax system in so far as in order to receive such authorisation, several conditions had to be fulfilled.[506] In a nutshell, the ECJ ruled that

> "it is necessary […] to compare that regime with the ordinary tax system, based on the difference between profits and outgoings of an undertaking carrying on its activities in conditions of free competition. […] Accordingly, the effect of the exclusion of those costs from the expenditure which serves to determine the taxable income of the centres is that the transfer prices do not resemble those which would

[502] See eg *Fiat* (SA.38375) Commission Decision 2016/2326 [2015] OJ L351, paras 129-139.
[503] See eg *Apple* (SA.38373) Commission Decision 2017/1283 [2016] OJ L187, paras 79-89; see also *Starbucks* (SA.38374) Commission Decision 2017/502 [2015] OJ L83, para 264.
[504] Emily Forrester, 'Is the State Aid Regime a Suitable Instrument to Be Used in the Fight Against Harmful Tax Competition' (2018) EC Tax Review 19, 31.
[505] Cf Werner Haslehner, 'Double Taxation Relief,Transfer Pricing Adjustments and State Aid Law' in Isabelle Richelle, Wolfgang Schön and Edoardo Traversa (eds), *State Aid Law and Business Taxation* (2016 Springer) 144ff.
[506] For more facts see Joined Cases C-182/03 and C-217/03 *Belgium and Forum 187 v Commission* [2006] ECR I-5479, paras 5ff.

be charged in conditions of free competition. It follows that such an exclusion confers an economic advantage on the centres."[507]

The ECJ concluded that MS should apply their national ALP for the right choice of the transfer pricing method and the right approximation of prices, as would have been charged in conditions of free competition. If that calculation and method turned out not to be similar to those charged in conditions of free competition, the tax measure or scheme conferred a selective advantage (effects doctrine). However, the Court did not provide any precise definition of what is considered as 'conditions of free competition' and no explicit referral to an existing EU ALP was made.

Some of the rather recent tax rulings assessed by the Commission and subsequently by the Court will be further explored.

(a) *Starbucks* and *Apple*

The *Starbucks* case concerned the intra-group sale of roasted coffee. The Commission objected to excessive royalties charged by the Dutch roasting company. It also found excessive prices for raw materials purchased internally. In essence, the GC held that the mere finding of a methodological error was not sufficient to show that the APA conferred an advantage.[508] Rather, the Commission had to additionally demonstrate that this error did not allow for an approximation of an arm's length result. This applied in particular to the Commission's argument that a specific transfer pricing method (TNMM) was preferred to another method proposed by the Commission (CUP).[509]

Similar observations were made in *Apple*, which concerned two tax rulings in favour of two companies in the Apple Group (ASI and AOE), that were incorporated under Irish law but not resident in Ireland for tax purposes. The Commission considered the rulings and the method used by which ASI and AOE determined their profits from the activities of the Irish branches, excluding profits from the use of IP licenses, to be incompatible State aid. The GC annulled the decision because the Commission had not demonstrated that an advantage actually existed.[510] In his opinion, AG Pitruzzella confirmed the Commission's decision and accused the GC of insufficient reasoning, as some allegedly important arguments of the Commission were not taken into account. He also placed more emphasis on the application of the ALP under the

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[507] Joined Cases C-182/03 and C-217/03 *Belgium and Forum 187 v Commission* [2006] ECR I-5479, paras 95-97.
[508] Joined Cases T-760/15 and T-636/16 *Netherlands v Commission* [2019] ECLI:EU:T:2019:669, paras 200-205.
[509] Joined Cases T-760/15 and T-636/16 *Netherlands v Commission* [2019] ECLI:EU:T:2019:669, para 427.
[510] Joined Cases T-778/16 and T-892/16 *Ireland v Commission* [2020] ECLI:EU:T:2020:338, in particular paras 312ff.

OECD approach, which seems odd given that the ECJ clearly emphasised in *Engie* and *Fiat* that national law should be used to determine the reference system.[511] On appeal, the ECJ fully confirmed the Commission's original decision from 2016.[512]

(b) *Fiat*

In November 2022, the ECJ delivered its judgment on the Commission's decision ordering Fiat to repay EUR 30 million in taxes to Luxembourg. The ruling is considered ground-breaking for the Commission's fight against alleged sweetheart tax deals to multinationals. It is not only a State aid case, but also a case concerning the competence of MS within the EU. The importance of the case is underlined by the fact that it was decided by the Grand Chamber.

The *Fiat* case concerned the accounting of intra-group financial services provided from Luxembourg. The Commission considered the general Luxembourg corporate tax system as the reference system with the aim of taxing the profits of all companies established in Luxembourg, whether integrated or not. In doing so, it assumed that both types of companies were in principle in a comparable factual and legal situation with regard to the objective of the system. According to the Commission, the method chosen by Luxembourg was artificial and complex and did not lead to an arm's length result. The Commission, by applying the autonomous ALP, considered that the tax ruling led to a reduction in Fiat's tax liability in Luxembourg and thus to an advantage, and concluded that the tax ruling constituted State aid.[513]

On appeal, the GC in essence supported the Commission's approach that integrated and stand-alone companies should be treated on equal terms, relying on the *Forum 187* judgement and the ALP as a benchmark.[514] The Commission had therefore rightly found that the tax ruling endorsed a methodology that did not allow for an arm's length outcome and thus conferred a selective advantage on the Fiat company in question.[515] The GC found that the evaluation of the tax ruling did not constitute tax harmonisation in disguise by the Commission. Rather, the Commission monitors compliance with Art 107 TFEU, so that it did not exceed its power by examining the compatibility of a tax ruling with the internal market.[516] The GC thereby

[511] C-465/20 P *Commission v Ireland and Others* [2023] ECLI:EU:C:2023:840, Opinion of AG Pitruzzella.
[512] Case C-465/20 P *Commission v Ireland and Others* [2024] ECLI:EU:C:2024:724.
[513] Joined Cases C-885/19 P and C-898/19 P *Fiat Chrysler Finance Europe v Commission* [2022] ECLI:EU:C:2022:859, paras 8-24.
[514] Joined Cases T-755/15 and T-759/15 *Luxembourg v Commission* [2019] ECLI:EU:T:2019:670, paras 134ff; see also Joined Cases T-760/15 and T-636/16 *Netherlands v Commission* [2019] ECLI:EU:T:2019:669, paras 141-157; Joined Cases T-778/16 and T-892/16 *Ireland v Commission* [2020] ECLI:EU:T:2020:338, para 213.
[515] Joined Cases T-755/15 and T-759/15 *Luxembourg v Commission* [2019] ECLI:EU:T:2019:670, paras 211-285.
[516] Joined Cases T-755/15 and T-759/15 *Luxembourg v Commission* [2019] ECLI:EU:T:2019:670, paras 104-117; see also Joined Cases T-760/15 and T-636/16 *Netherlands v Commission* [2019] ECLI:EU:T:2019:669, paras 158-160; Joined Cases T-778/16 and T-892/16 *Ireland v Commission* [2020] ECLI:EU:T:2020:338, paras 103-124.

validated the autonomous character of the State aid notion and consequently the autonomous concept of the ALP. Moreover, it corroborated that tax law may differentiate between integrated and independent companies. This finding ultimately also confirmed the wide discretion of the Commission.

In his opinion, AG Pikamäe proposed that the ECJ set aside the GC's judgment in *Fiat*, as it erred in law in approving the reference framework comprising an ALP alien to national law.[517] According to the AG, as the GC rightly held, the Commission was not obliged to take into account the intra-group cross-border dimension of the tax ruling's effects.[518] The AG found that the introduction of the ALP into the Commission's assessment disregards the division of competences between the EU and its MS and derives from national law rather than from Art 107 TFEU.[519] The AG considered that the reference by both the Commission and the GC to the *Forum 187* judgment on the ALP is not convincing, as the Court did not oblige the MS to implement this principle into their national law.[520]

In its judgement, the ECJ addressed some important aspects of the State aid review of APAs, overturned the GC ruling and annulled the underlying Commission decision. First and foremost, the ECJ clarified the question of the existence of an autonomous ALP by making it clear that the reference system must consist of national law and not a hypothetical ALP. In doing so, the ECJ rejected the Commission's interpretation of *Forum 187*.[521] The ECJ ruled that only the national law of the MS is to be taken into account when establishing the reference system. Instead, the Commission and GC interfered with the tax sovereignty of MS by relying on a definition of the objective of the tax system based on an ideal version of the ALP without taking into account how it was actually incorporated into national tax law.[522]

Unfortunately, the ECJ did not address whether a broad or narrow definition of the reference system should have been chosen and whether Luxembourg had applied the national legislation correctly. The ECJ thus refused to consider the Commission's subsidiary argument that the tax

[517] Case C-898/19 P *Ireland v Commission and Others* [2021] ECLI:EU:C:2021:1029, Opinion of AG Pikamäe, paras 146 and 198.
[518] Case C-885/19 P *Fiat Chrysler Finance Europe v Commission* [2021] ECLI:EU:C:2021:1028, Opinion of AG Pikamäe, paras 56ff.
[519] Case C-898/19 P *Ireland v Commission and Others* [2021] ECLI:EU:C:2021:1029, Opinion of AG Pikamäe, paras 5, 94 and 107-112.
[520] Case C-885/19 P *Fiat Chrysler Finance Europe v Commission* [2021] ECLI:EU:C:2021:1028, Opinion of AG Pikamäe, paras 79-80; Case C-898/19 P *Ireland v Commission and Others* [2021] ECLI:EU:C:2021:1029, Opinion of AG Pikamäe, paras 120-121.
[521] Joined Cases C-885/19 P and C-898/19 P *Fiat Chrysler Finance Europe v Commission* [2022] ECLI:EU:C:2022:859, paras 102-104.
[522] Joined Cases C-885/19 P and C-898/19 P *Fiat Chrysler Finance Europe v Commission* [2022] ECLI:EU:C:2022:859, paras 72-74.

ruling should be regarded as State aid even if the Luxembourg scheme was used as the reference system.[523]

The crux of the judgment comes in para 122, where the ECJ held that

> "[…] after having observed that a Member State has chosen to apply the arm's length principle in order to establish the transfer prices of integrated companies, the Commission must […] be able to establish that the parameters laid down by national law are manifestly inconsistent with the objective of non-discriminatory taxation of all resident companies, whether integrated or not, pursued by the national tax system, by systematically leading to an undervaluation of the transfer prices applicable to integrated companies or to certain of them […] as compared to market prices for comparable transactions carried out by non-integrated companies."[524]

On the one hand, the ECJ emphasised that the possibility that direct tax measures may be classified as State aid is not excluded, provided that all the conditions for the application of Art 107(1) TFEU are met. Measures taken by MS in areas not subject to harmonisation are not excluded from the scope of the provisions of the TFEU. Thus, they must exercise their competences in the field of direct taxation in accordance with EU law and thus also State aid law. On the other hand, it clarified that the Commission can only define the reference system by reference to the national law of the MS concerned, which includes the (national) ALP. The Commission must demonstrate that transactions between stand-alone companies have been systematically discriminated against compared to comparable transactions between integrated companies. This is a relatively high standard, but it leaves the door open for further investigations into fiscal State aids.

It is also striking that the basic idea of the analysis under Art 107(1) TFEU is equated with the principle of non-discrimination in the context of fundamental freedoms. Such an equation is made clear in the AG's opinion[525] and confirmed by the ECJ.[526]

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523 Joined Cases C-885/19 P and C-898/19 P *Fiat Chrysler Finance Europe v Commission* [2022] ECLI:EU:C:2022:859, paras 318ff.

524 Joined Cases C-885/19 P and C-898/19 P *Fiat Chrysler Finance Europe v Commission* [2022] ECLI:EU:C:2022:859, para 122.

525 Case C-898/19 P *Ireland v Commission and Others* [2021] ECLI:EU:C:2021:1029, Opinion of AG Pikamäe, paras 154-155.

526 Joined Cases C-885/19 P and C-898/19 P *Fiat Chrysler Finance Europe v Commission* [2022] ECLI:EU:C:2022:859, paras 70 and 122.

(c) *Amazon*

Amazon concerned the payment of royalties by Amazon EU Sàrl, a Luxembourg-based company, to Amazon Europe Holding Technologies SCS (Amazon SCS). Under Luxembourg law, an SCS is a transparent company that is not subject to corporate income tax. Since Amazon SCS, which is held by US entities, was also not taxed in the US, taxation was simply avoided. The tax ruling in question and the method agreed on between Luxembourg and Amazon to determine the appropriate royalty allowed Amazon to shift most of its profits to Amazon SCS so that they were not taxed. Therefore, the Commission found that the tax ruling constituted incompatible State aid in that the transfer pricing agreement was not consistent with the OECD ALP.[527] The reasoning of the GC is similar to that in *Starbucks* and *Apple*. The Court again started by stating that the Commission's assessment does not interfere with the MS' fiscal autonomy.[528] As in the previous judgments, the GC held that a methodological error in the application of the ALP is not sufficient to prove the existence of a selective advantage. The Commission must additionally show that this error leads to a reduction of the tax burden compared to the tax burden when applying the 'normal' taxation rules.[529] According to the Court, the Commission underestimated the functions of Amazon SCS in providing tangible assets with a unique and valuable role.[530] In addition, the Commission had not justified its choice of transfer pricing method and had applied an erroneous methodology overall.[531] Thus, the GC annulled the Commission's decision.

AG Kokott addressed the question of whether and to what extent the ECJ has jurisdiction to review the correct calculation of a transfer price. She clarified that neither the Commission nor the Court can judge national tax law on the basis of an ideal or fictitious tax system. Although the Commission considered that the complaint was unfounded as neither Luxembourg nor Amazon challenged the reference system, the AG noted that its determination could not be considered in isolation. Hence, the Commission limited itself to finding a reflection of the OECD transfer pricing rules in national law, although no explicit reference was made to them. It thus took into account rules external to the national system without considering how they were actually incorporated into national law, thereby committing an error of law.[532] Moreover,

[527] Joined Cases T-816/17 and T-318/18 *Luxembourg v Commission* [2021] ECLI:EU:T:2021:252, paras 1ff.
[528] Joined Cases T-816/17 and T-318/18 *Luxembourg v Commission* [2021] ECLI:EU:T:2021:252, para 113.
[529] Joined Cases T-816/17 and T-318/18 *Luxembourg v Commission* [2021] ECLI:EU:T:2021:252, para 123.
[530] Joined Cases T-816/17 and T-318/18 *Luxembourg v Commission* [2021] ECLI:EU:T:2021:252, para 244.
[531] Joined Cases T-816/17 and T-318/18 *Luxembourg v Commission* [2021] ECLI:EU:T:2021:252, paras 296 and 501.
[532] Case C-457/21 P *Commission v Amazon.com and Others* [2023] ECLI:EU:C:2023:466, Opinion of AG Kokott, paras 53-79.

AG Kokott stated that the determination of the reference system is a question of law that can be reviewed on appeal. However, this entails the difficulty that the Court must review and interpret complex issues of national law. She therefore referred to her proposal for a modified standard of review, in which only tax measures and laws that are designed in an inconsistently and manifestly discriminatory manner should be reviewed.[533] In conclusion, the AG sided with the GC and was of the opinion that the Commission could not prove a selective advantage.

On appeal, the ECJ essentially repeated its statements and explanations from the *Fiat* case, including the finding that there is no autonomous ALP that applies independently of its incorporation into national law.[534] The ECJ found that the reference system was wrongly determined by the GC as it relied on the OECD ALP, irrespective of its incorporation into Luxembourg law. In doing so, it failed to consider that the OECD guidelines are not binding on the MS. Nevertheless, the GC's finding does not necessarily have to be overturned if the operative part of the judgment is well founded on other legal grounds, which is the case here. First, there is no autonomous ALP principle. Second, the Commission could not simply read the existence of an ALP into the national provision. Third, the OECD guidelines cannot be applied without demonstrating that they have been transposed into national law. Consequently, the Commission has not established the existence of an advantage for Amazon.[535]

(d) *Engie*

The *Engie* case dealt with intra-group financial transactions that resulted in a structure that again led to double non-taxation, as the same income was simultaneously treated as debt (deductible interest) and as equity (tax exempt). Here too, the Commission qualified the tax ruling as incompatible State aid that enabled Engie to avoid tax by the use of convertible loans between different Luxembourg companies of the Engie group. The Commission justified this by stating that the reference framework comprised the Luxembourg corporate tax system, limited to the provisions on the taxation of profit distributions and the exemption of income from participations. The derogation from this led to discrimination in favour of the holding companies concerned, as parent companies in a comparable situation were not entitled to an exemption of their income from participations if the distributed profit was not previously taxed at the level of the subsidiaries.[536] The starting point of the GC was very similar to that of *Amazon*, referring to the effects-based approach and the fact that the non-application of the anti-

[533] Case C-457/21 P *Commission v Amazon.com and Others* [2023] ECLI:EU:C:2023:466, Opinion of AG Kokott, paras 84-101.
[534] Case C-457/21 P *Commission v Amazon.com and Others* [2023] ECLI:EU:C:2023:985, paras 31ff.
[535] Case C-457/21 P *Commission v Amazon.com and Others* [2023] ECLI:EU:C:2023:985, paras 47-59.
[536] Joined Cases T-516/18 and T-525/18 *Luxembourg v Commission* [2021] ECLI:EU:T:2021:251, paras 1ff.

avoidance rule constitutes a derogation from the reference system, which consisted of two provisions of the Luxembourg Law on income tax. The GC, again, examined both the condition of selectivity and advantage together as one condition. It ultimately rejected the appeals and confirmed the decision of the Commission.[537]

The opinion of AG Kokott is interesting insofar as it advocates an examination under State aid law of tax measures and decisions that are designed in a manifestly discriminatory manner and are aimed at a circumventing the State aid rules. Accordingly, only those (manifest) derogations that cannot be plausibly explained to a third party (plausibility check) are to be examined, and not those that are merely incorrect applications or rulings. Here it touches on the very valid point that the Commission and the CJEU would otherwise have to correctly interpret all national tax rules, which would lead to an overload that already exists even without this task. In the present case, both the Commission and the GC followed a different interpretation of the Luxembourg provisions than that set out by Engie and Luxembourg. It is for the national authorities and courts to assess the correct application of the national rules. If every error were to be considered an infringement of Art 107 TFEU, the Commission and the CJEU would become supreme tax auditors and courts.[538] The AG stated that the Commission and the GC have defined an incorrect reference framework by adopting a certain rule into national law which is not obvious. It also clarified the purpose of group relief, which is to prevent double taxation and to ensure the tax exemption of the subsidiary when distributing its profit to the parent company. This is a common and widely accepted practice, the form of which MS are free to decide.[539] The interpretation of the reference framework, as it was done, would have required an assessment of Luxembourg case law and administrative practice, which was not the case.[540]

On appeal, the ECJ departed from the findings of the Commission and the GC. Based on the determination of the reference system, the Court stated that this must result from an objective examination of the content, structure and effects of the provisions of national law. In this context, even the reference framework itself may be incompatible with State aid law if it has

[537] Joined Cases T-516/18 and T-525/18 *Luxembourg v Commission* [2021] ECLI:EU:T:2021:251, paras 327, 335, 351 and 472; on a similar note, in Case T-648/19 *Nike and Converse v Commission* [2021] ECLI:EU:T:2021:428, the GC dismissed the appeal and upheld the Commission decision.
[538] Joined Cases C-451/21 P and C-454/21 P *Engie Global LNG Holding and Others v Commission* [2023] ECLI:EU:C:2023:383, Opinion of AG Kokott, paras 86-101.
[539] Joined Cases C-451/21 P and C-454/21 P *Engie Global LNG Holding and Others v Commission* [2023] ECLI:EU:C:2023:383, Opinion of AG Kokott, paras 107-129.
[540] Joined Cases C-451/21 P and C-454/21 P *Engie Global LNG Holding and Others v Commission* [2023] ECLI:EU:C:2023:383, Opinion of AG Kokott, paras 152-154 and 163.

been designed according to manifestly discriminatory parameters in order to circumvent this law.[541] The ECJ followed the opinion of AG Kokott and found an error in the determination of the reference system by the Commission and GC.[542] It also clarified that the classification of a measure as selective requires knowledge of the content of the relevant national provisions and an examination of the related national administrative and judicial practice.[543] The Commission was unable to demonstrate that the national authorities had deviated from their practice in relation to comparable transactions and had therefore not sufficiently demonstrated that the national provisions had been infringed. It is not possible to justify a derogation by stating that a measure departs from a general objective of taxing all companies without referring to the provisions setting out the way in which that objective is to be implemented.[544]

3.3.4. Preliminary Findings for Tax Rulings

Despite the loud voice of MS and their concerns that the Commission is engaging in disguised tax harmonisation, the Court has clarified that tax measures, including tax rulings, can fall within the scope of State aid law and therefore are examined under Art 107 TFEU. This seems to be a natural consequence of preserving the (competitiveness of the) internal market. Tax rulings as such are not a problem, but serve to ensure legal certainty. They are only problematic if they are misused to circumvent the applicable laws. The transfer pricing method is usually agreed between the national tax authorities and the taxpayer on the basis of an ALP. The best-known source is the OECD ALP, which is however not binding. Not every country has adopted an ALP into its national law.

However, what does not seem so self-evident is the fact that if national law does not distinguish between integrated and national companies, the Commission can choose the transfer pricing method it considers most appropriate. The Commission not only checks the correctness of the method applied, but performs an own assessment of the objectivity of the tax calculation. In order to avoid selectivity, the Commission believes that group companies and stand-alone companies should be treated equally. Thus, the Commission does not compare between undertakings that receive a tax ruling but between an undertaking that receives a tax ruling and an undertaking that does not receive a tax ruling, i.e. they are not in a comparable situation from

[541] Joined Cases C-451/21 P and C-454/21 P *Luxembourg v Commission* [2023] ECLI:EU:C:2023:948, paras 104-114.
[542] Joined Cases C-451/21 P and C-454/21 P *Luxembourg v Commission* [2023] ECLI:EU:C:2023:948, paras 115-132.
[543] Joined Cases C-451/21 P and C-454/21 P *Luxembourg v Commission* [2023] ECLI:EU:C:2023:948, paras 151-160.
[544] Joined Cases C-451/21 P and C-454/21 P *Luxembourg v Commission* [2023] ECLI:EU:C:2023:948, paras 168-186.

the outset. A recent novelty in the Commission's approach to tax rulings was the reference to the ALP and the associated argument that it derives from Art 107 TFEU and as such constitutes an autonomous principle. The emergence and implementation of such an autonomous ALP would lead to an unpredictable ex post ad hoc assessment of tax rulings. Especially, the Commission did not indicate what exactly this principle entails, how it is to be applied and to what extent a reference to the OECD is permissible.[545] The Commission rather compares by means of an ideal model instead of referring to reality and common practice in a MS.

The Commission's assumption that there is an autonomous European ALP, which is enshrined in Art 107 TFEU, led to a wave of cases before the European courts. In addition, the Commission frequently criticised the chosen transfer pricing method and decided that a different one should have been chosen. In this way, it constructed the reference system itself, not by taking into account the applicable national laws and principles, but through an artificial ALP and a self-determined transfer pricing method. In such a situation, APAs and rulings can hardly be considered de jure selective if a relevant reference system is simply not in place. The tax ruling cases gave the CJEU the opportunity to further clarify the determination of the reference system.

The ECJ clarified that only national law should be used to determine the reference system. The Commission must prove that there has been systematic discrimination against (stand-alone) companies carrying out comparable transactions (see *Fiat*, *Amazon* and *Engie*). It is precisely in these cases that not only the AGs, but also the Court itself, warn of the dangers that the determination of the reference system entails, namely the fact that the Commission and the Court become a kind of supreme tax authority and court in assessing the correct determination of the reference system, which should consist only of national law. Although the ECJ rejected the idea of an 'ideal' (EU) version of the ALP that does not take into account relevant national law and emphasised the importance of national law as the reference framework, it is not clear to what extent the Commission must also refer to national tax administrative practice implementing national legislation and national case law. This is true, especially regarding the fact that tax rulings are normally about the (arbitrary) application of the law by the authorities, not about the law itself. This also leads to the question of whether a wide margin of discretion granted by the national legislator to the tax administration in implementing the ALP automatically means that it is State aid. Even in the absence of such wide discretion, it was not

[545] See also Thomas Jaeger, 'Schwächen der Prüfung von Steuerbeihilfen am Beispiel der Urteile Fiat und Starbucks' (2020) EuZW 18, 22.

specified which characteristics a tax ruling must have in order to be considered State aid. The question of the correct definition of the reference system is therefore directly linked thereto. The ECJ admittedly held that national law must be chosen, but not how broadly or narrowly such a reference system is to be understood. An immediate consequence of these judgements is that the Commission has to adapt its 2016 Notice, as it explicitly refers to the existence of an autonomous ALP under Art 107(1) TFEU. This reference must be deleted in the future to comply with the judgments.

3.4. Interim Conclusion on Material Selectivity

In light of the analysis described above, it can be concluded that the Court has been rather supportive of the Commission's evolving policy. Accordingly, the three-step test has been progressively developed in the case law of the CJEU.[546] The main requirement of the methodological framework of Art 107 TFEU is that taxpayers must be treated equally in similar factual and legal circumstances. It should be noted that neither the Commission nor the CJEU are consistent in their language and choice of terms. The CJEU confusingly uses different wording and approaches to 'normal taxation' and the derogations thereof.[547] Today, the rather outdated three-step test, applying the logic of the rule-exception, is combined with a much more forward-thinking comparability assessment. In *Paint Graphos*, the Court clearly distinguished the three steps of the derogation approach as separate steps.[548] It applied the Commission's derogation approach and its own comparative approach from *Adria-Wien Pipeline* concurrently.

The first criterion demands the determination of the reference system. As has become clear in the above analysis of case law, the main problem lies in determining the correct reference system in order to then depart from it in a second step and carry out a comparability analysis. So far, there are simply no guidelines on how to determine this. It is generally determined on a case-by-case basis. There can be different understandings of it, which makes this criterion very confusing. This is reflected, for example, in the fact that sometimes the general income tax is chosen and sometimes the measure itself. Therefore, even if there is no formal derogation, a measure is not automatically of a general nature. The tax ruling cases made it clear that the

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546 Case T-399/11 *Banco Santander and Santusa v Commission* [2014] ECLI:EU:T:2014:938, para 37; Case T-219/10 *Autogrill España v Commission* [2014] ECLI:EU:T:2014:939, para 33; Case T-210/02 RENV *British Aggregates v Commission* [2012] ECLI:EU:T:2012:110, para 49; Joined Cases C-20/15 P and C-21/15 P *Commission v World Duty Free Group, Banco Santander and Santusa* [2016] ECLI:EU:C:2016:981.

547 Cf Joined Cases C-20/15 P and C-21/15 P *Commission v World Duty Free Group, Banco Santander and Santusa* [2016] ECLI:EU:C:2016:981, paras 63 and 65 (reference system); Case C-374/17 *A-Brauerei* [2018] ECLI:EU:C:2018:1024, paras 37 and 41 (reference framework); Case T-210/02 RENV *British Aggregates v Commission* [2012] ECR II-2789, para 73 (normal rule).

548 Joined Cases C-78/08 to C-80/08 *Paint Graphos* [2011] ECR I-7611, paras 49 and 64.

reference system may only be compiled taking into account national law and the principles laid down therein. This makes it however difficult for the Commission and the Courts to verify the right choice without interfering with the competence of the MS and without interpreting national law.

The second step involves the analysis of whether the measure at hand derogates from this reference system and differentiates between taxpayers who are in a similar factual and legal situation. With regard to the second step, it has been shown that neither the understanding of a derogation nor the comparators used to compare or distinguish companies follow a coherent pattern. Instead of trying to find a way to establish a derogation from the previously defined reference system, it would make more sense to reduce this step to a comparability analysis of undertakings in the same or a similar legal and factual situation, having regard to the objective of the measure. Selectivity is ultimately about identifying a significant distinction between similar situations, not just an exception to a supposed general rule. This comparison exercise is the core of the analysis. Even if it is not always formally labelled as equal treatment or non-discrimination, the Court applies a similar test to that applied to fundamental freedoms. Basically, it is practically the same. Recourse to this concept is therefore already taking place, albeit only implicitly. In order to standardise and structure the test so that it is comprehensible to everyone, it would make sense to firmly incorporate the requirement and principle of non-discrimination. The extent to which the test as a whole could or should look like is explored in Chapter 5.

Last but not least, the nature or general scheme of the tax system will be checked for the eventuality of a justification of the derogation. The justification analysis in its current form also refers to different benchmarks and confuses the second and third step of the test by alternately considering the objective of the measure and the system. Instead, the focus should be on the objective of the system, non-compliance with which should be demonstrated by the Commission, and not vice versa, where compliance must be proven by the MS.

The analysis shows how the selectivity test has created a climate of legal uncertainty in which the outcomes of State aid cases depend not only on legal principles but also on the subjective interpretation of judges. This unpredictability not only undermines the effectiveness of EU competition law, but also fosters a regulatory environment characterised by ambiguity and inconsistency. Despite the progress made, the Court's case law, and thus negative harmonisation, is insufficient to provide an efficient solution to the issue of selectivity in State aid cases in the tax area. Establishing a rule and an exception is a subjective and arbitrary exercise. Different tax rules have different scopes of application and different legal consequences. The deviating provision is almost automatically suspected of being State aid, leading to a reduced room for manoeuvre of the MS in fiscal policy.[549] In tax systems, there are many exceptions that are nested within each other, making it difficult to see which are compatible with the reference framework and which are not.[550] In other cases, a measure does not always present itself as an exception, which can lead to the need to examine the national tax system as a whole to find a rule from which the measure could be an exception. On the contrary, there are cases where the Court has identified the reference system and its objective without further difficulty.[551] The difficulties in practice and in the application of the concept were most evident in the different approaches of the GC and the ECJ, which led to many GC judgements being overturned.[552]

Thus, despite the rich amount of case law on the selectivity criterion, its concept is still not unambiguously defined. In order to clarify the selectivity criterion, fixed benchmarks are needed to determine the comparability of situations, including the reference system and the objective pursued. This is all the more true for fiscal aid measures.[553] The yardsticks chosen for comparison have a big impact on the determination of a privileged category. The broader the reference framework, the easier it is to determine a privileged group of beneficiaries. But even the recent decisions of the CJEU do not seem to open the way for a reconsideration of the definition of selectivity. Rather, the Court's approach raises more questions than it answers.

As already mentioned, on closer examination, it becomes clear that the approach taken under the selectivity analysis is similar to that of the principle of equal treatment under Union law as applied in the context of the fundamental freedoms, as both involve similar processes in identifying categories of legal subjects whose legal treatment is being compared and in assessing the justifications for different treatment. This parallel has been confirmed by case law.[554] Therefore, in a next research step, the Court's methodology in the area of fundamental

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[549] See also Michael Lang, 'State Aid and Taxation: Selectivity and Comparability Analysis' in Isabelle Richelle, Wolfgang Schön and Edoardo Traversa (eds), *State Aid Law and Business Taxation* (Springer 2016) 34-35.
[550] Rita Szudoczky, 'Convergence of the Analysis of National Tax Measures under the EU State Aid Rules and the Fundamental Freedoms' (2016) EStAL 357, 363; see also Nicolas Martinez, 'Sélectivité en matière fiscale: Une analyse généalogique de la méthode en trois étapes' (2019) 55(2) Cahiers de droit européen 485, 539.
[551] Case C-374/17 *A-Brauerei* [2018] ECLI:EU:C:2018:1024, paras 37 and 39.
[552] See Joined Cases C-20/15 P and C-21/15 P *Commission v World Duty Free Group, Banco Santander and Santusa* [2016] ECLI:EU:C:2016:981; Case C-203/16 P *Andres (faillite Heitkamp BauHolding) v Commission* [2018] ECLI:EU:C:2018:505.
[553] See also Case C-78/08 to C-80/08 *Paint Graphos and Others* [2010] ECLI:EU:C:2010:411, Opinion of AG Jääskinen, para 80.
[554] Case C-524/14 P *Commission v Hansestadt Lübeck* [2016] ECLI:EU:C:2016:971, para 53; see also Case T-210/02 RENV *British Aggregates v Commission* [2012] ECLI:EU:T:2012:110, para 68.

freedoms must be examined in more detail in order to ultimately clarify whether the principle of non-discrimination can serve as a model for the test under Art 107(1) TFEU.

4. Lessons from the Fundamental Freedoms? The Treatment of Tax Measures and the Application of the Non-Discrimination Test in the Context of Fundamental Freedoms

The last chapter highlighted the contradictions and conflicts in the case law of the Court regarding the selectivity test for tax measures under the State aid rules of Art 107 TFEU. From the development of the case law, it appears that reference is made to the requirement of equal treatment, with the inclusion of a condition of non-discrimination when assessing the comparability of situations. Such a non-discrimination test in direct tax cases is well known in the context of the analysis of fundamental freedoms. It is therefore useful to examine what this non-discrimination test looks like and how it is applied by the Court in order to consider whether such a test could or should be formally included in the selectivity analysis under Art 107 TFEU. The assessment of convergence is discussed later in Chapter 5, which focuses on the meaning and relevance of the transition to non-discrimination for tax cases under the State aid rules and whether there is a common notion of non-discrimination in the case law of the CJEU or whether such notion must first be created. It can already be surmised that the non-discrimination test in this chapter is also not based on a completely standardised methodology.

As was previously discussed, in principle, regulatory sovereignty in the area of direct taxation rests with the MS due to a harmonisation gap at EU level. However, the ECJ regularly emphasises that MS must exercise their powers in the area of direct taxation in compliance with EU law. This principle was explicitly formulated in the *Schumacker*[555] (free movement of workers) and *Wielockx*[556] (freedom of establishment) judgments and has since been followed and confirmed. ECJ President, Koen Lenaerts, refers to this principle as the framework principle (*Umrahmungsprinzip*) of EU law, according to which, on the one hand, the MS must respect the Treaties and thus the prohibition of discrimination and, on the other, the EU must respect the powers of the MS.[557] This includes, above all, the general prohibition of discrimination of Art 18 TFEU and the fundamental freedoms. As instruments for the realisation of the internal market and fundamental principles of the Treaty, the free movement of workers, the freedom of establishment and the freedom to provide services, together with the free movement of goods, capital and payments, are among the constituent fundamental freedoms.[558]

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[555] Case C-279/93 *Schumacker* [1995] ECR I-225, para 21.
[556] Case C-80/94 *Wielockx* [1995] ECR I-2493, para 16.
[557] Koen Lenaerts, 'Die Entwicklung der Rechtsprechung des Gerichtshofs der Europäischen Gemeinschaften auf dem Gebiet der direkten Besteuerung' (2009) EuR 728, 729ff.
[558] Art 26 TFEU; Ernst Forsthoff and David Eisendle, 'Art 45 AEUV', in Eberhard Grabitz, Meinhard Hilf and Martin Nettesheim (eds), *Das Recht der Europäischen Union* (78th edn, Beck 2023) paras 1-3.

The fundamental freedoms are aimed at discriminatory and restrictive (tax) provisions and measures stemming from the (tax) system of a MS. In principle, there is no practical difference between discriminations and restrictions. The interpretation of these two terms is constantly changing and adapting, leaving their true meaning and ultimately their relationship to each other open to debate.[559] However, it seems that the only difference that exists is that between the two meanings of restriction. On the one hand, restrictions may arise due to the inevitable co-existence of national tax systems, which may result in double compliance burdens for companies operating cross-border or the necessity to divide tax jurisdiction (quasi-restrictions). On the other hand, true restrictions exist, which indeed fall within the scope of Union law, discriminating companies due to the rules of one jurisdiction.[560] In its case law, the ECJ uses the terms discrimination and restriction inconsistently. Therefore, the term restriction can also be understood and used as a generic term for the different forms of discrimination.[561]

Obstacles and restrictions to free movement rights can take various forms, such as dislocations, disparities or double burdens. Dislocations emanate from the splitting up of one tax base, the income, over two jurisdictions, which leads to a double burden or the separation of the income into two parts without the possibility of cancelling each other out.[562] The problem of dislocation, therefore, involves two countries with the same system. On the contrary, disparities occur from the differences between two tax systems. MS enjoy tax sovereignty and may choose different connecting factors for defining their tax jurisdiction.[563] A classic example of direct tax disparity is the *Schempp* case. Mr Schempp, a German resident, paid alimony to his ex-wife, who had moved to Austria. Mr Schempp could not deduct this payment from his income because the German rules provided that the payer could deduct alimony payments if they were taxed in the hands of the recipient. However, his ex-wife was not taxed in Austria for alimony payments.[564] The Court held that Art 18 TFEU (the general principle of equality) does not apply to disparities in treatment resulting from divergences between MS' tax systems, as long as they affect all

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[559] See eg Alina Tryfonidou, 'The Notions of 'Restriction' and 'Discrimination' in the Context of the Free Movement of Persons Provisions: From a Relationship of Interdependence to one of (Almost Complete) Independence' (2014) 33(1) Yearbook of European Law 385.
[560] Case C-374/04 *Test Claimants in Class IV of the ACT Group Litigation* [2006] ECR I-11673, Opinion of AG Geelhoed, paras 36ff.
[561] Case C-382/16 *Hornbach-Baumarkt* [2017] ECLI:EU:C:2017:974, Opinion of AG Bobek; cf Case C-565/18 *Société Générale* [2019] ECLI:EU:C:2019:1029, Opinion of AG Hogan, paras 35-36; see also Juliane Kokott and Hartmut Ost, 'Europäische Grundfreiheiten und nationales Steuerrecht' (2011) EuZW 496, 498.
[562] Ben Terra and Peter Wattel*, European Tax Law, Fiscale Handboeken* (2nd edn, Kluwer Law International 2012) 95.
[563] Ben Terra and Peter Wattel*, European Tax Law, Fiscale Handboeken* (2nd edn, Kluwer Law International 2012) 96-99.
[564] Case C-403/03 *Schempp* [2005] ECR I-6421, para 32.

persons according to objective criteria and without regard to nationality.[565] Furthermore, the ECJ dismissed the argument that German law restricts the exercise of free movement and residence rights of EU citizens stipulated in Art 21(1) TFEU. It clarified that the Treaties do not guarantee neutrality of taxation in the case of resettlement.[566] Hence, disparities arising from different tax systems, rates or advantages cannot be brought within the scope of the freedoms. It was later explicitly settled that double taxation falls outside their scope.[567] Moreover, the Court held that EU law does not entail rules in order to determine a MS priority in exercising its taxing power or any obligation for MS to adapt their systems to those of other MS.[568]

Former AG Geelhoed[569] and certain authors[570] distinguish a third category of obstacles resulting from the co-existence of national tax systems. Those are double formalities, which result in greater administrative compliance burdens on companies operating cross-border causing economic disadvantages for such activities. Consequently, disparities also arise when two identical systems are applied alongside each other. The *Futura* case is an exceptional double burden case where a non-discriminatory measure was found to be a restriction of the freedom of establishment. A Luxembourg provision made the carry-forward of losses by permanent establishments of non-resident companies subject to the requirement that in years of losses, separate accounts must be kept in the State of the permanent establishment. Hence, a company had to keep accounts in the State of the permanent establishment and in the State of its seat. The ECJ qualified this double burden as a restriction on the freedom of establishment.[571] The striking effect of this case is the fact that a neutral tax measure, which was applicable to both resident and non-resident companies, was considered to infringe the fundamental freedoms. This means that discrimination may arise where the same rule is applied to different situations.[572] Hence, regulatory double burdens are not approached in the same manner as

[565] Case C-403/03 *Schempp* [2005] ECR I-6421, para 34.
[566] Case C-403/03 *Schempp* [2005] ECR I-6421, paras 44ff; cf Case C-336/96 *Gilly* [1998] ECR I-2793; Case C-414/06 *Lidl Belgium* [2008] ECR I-3601.
[567] Eg Case C-513/04 *Kerckhaert and Morres* [2006] ECR I-10967, paras 20 and 22; Case C-67/08 *Block* [2009] ECR I-883; Case C-128/08 *Damseaux* [2009] ECR I-6823; Case C-540/11 *Levy and Sebbag* [2012] ECLI:EU:C:2012:581; Georg Kofler, 'Double Taxation and European Law: Analysis of the Jurisprudence' in Alexander Rust (ed), *Double Taxation within the European Union* (Kluwer Law International 2011) 106.
[568] Case C-67/08 *Block* [2009] ECR I-883, para 30; Case C-128/08 *Damseaux* [2009] ECR I-6823, paras 30ff.
[569] Case C-374/04 *Test Claimants in Class IV of the ACT Group Litigation* [2006] ECR I-11673, Opinion of AG Geelhoed, para 37.
[570] See eg Dennis Weber, 'In search of a (new) equilibrium between tax sovereignty and the freedom of movement within the EC' (2006) 34 Intertax 585, 597; Axel Cordewener, 'The Prohibitions of Discrimination and Restriction within the Framework of the Fully Integrated Internal Market' in Frans Vanistendael (ed), *EU Freedoms and Taxation* (IBFD 2006) 38; Joachim Englisch, 'Tax Coordination between Member States in the EU - Role of the ECJ' in Michael Lang and others (eds), *Horizontal Tax Coordination* (IBFD 2012).
[571] Case C-250/95 *Futura Participations and Singer* [1997] ECR I-2471, paras 24-26 and 43.
[572] Cf Case C-279/93 *Schumacker* [1995] ECR I-225, para 30.

double taxation. Regulatory double burdens are caught under the fundamental freedoms and resolved by the mutual recognition principle, whereas double taxation is not. The restrained attitude of the CJEU has triggered a bulk of criticism among academics.[573]

The Court applies a simple discrimination standard when reviewing the compatibility of tax measures with the fundamental freedoms to the effect that measures applied without distinction to domestic and cross-border situations do not fall under the prohibitions of the free movement provisions. A possible explanation may be the highly political and sensitive nature of fiscal issues. In consequence thereof, the discrimination standard affects non-discriminatory tax measures in as much as they fall outside the scope of fundamental freedoms despite their potential negative effects.[574] Similarly, fiscal rules not discriminating between domestic and cross-border situations as such but causing obstacles to the free movement due to their interaction with rules of other States remain outside the scope of the fundamental freedoms. Only direct tax measures which treat cross-border situations less favourably than comparable domestic situations are caught by the fundamental freedoms listed below.

4.1. Non-Discrimination Test under the Fundamental Freedoms: Four-Step Approach

In tax cases, as in all other cases involving obstacles to individuals or companies exercising their Treaty freedoms, a non-discrimination test is applied under the fundamental freedoms. In establishing an infringement, the CJEU adopts a four-step approach: It must first be determined whether a measure actually falls within the scope of a freedom. Second, this freedom must be restricted or a measure must discriminate between objectively comparable situations in a cross-border context. This involves identifying unequal treatment that worsens a cross-border situation. Third, it is then examined whether such discrimination or restriction can be justified on the basis of the Treaty (direct discrimination) or on the basis of a legitimate objective and imperative reasons in the public interest (all other forms of discrimination). If so, fourth, the

573 See Frans Vanistendael, 'The ECJ at the crossroads: balancing tax sovereignty against the imperatives of the single market' (2006) 46 European Taxation 413, 418ff pointing out that the OECD Model Convention and the Parent-Subsidiary Directive provide for the elimination of double taxation by the residence State, which should serve as source of inspiration; similarly Axel Cordewener, 'The Prohibitions of Discrimination and Restriction within the Framework of the Fully Integrated Internal Market' in Frans Vanistendael (ed), *EU Freedoms and Taxation* (IBFD 2006) 38; for a different view see Alexander Rust, 'How European Law Could Solve Double Taxation' in Alexander Rust (ed), *Double Taxation within the European Union* (Kluwer 2011) 145-154 where he maintains that specific tax treaties and the recourse to an equal treatment obligation provide a better solution; on the other extreme, explaining that national tax sovereignty would be compromised in case of intervention see Dennis Weber, 'In search of a (new) equilibrium between tax sovereignty and the freedom of movement within the EC' (2006) 34 Intertax 585, 609; similarly Ben Terra and Peter Wattel, *European Tax Law, Fiscale Handboeken* (2nd edn, Kluwer Law International 2012) 904.

574 Although few exceptions exist, see eg Case C-250/95 *Futura Participations and Singer* [1997] ECR I-2471; Case C-293/06 *Deutsche Shell* [2008] ECR I-1129.

measure must be proportionate and suitable to achieve the aim and must not go beyond what is necessary to achieve that aim.[575]

Accordingly, the constitutive elements of the non-discrimination test are the comparability of situations, the difference in treatment and the justification thereof. Having established that two situations are indeed objectively comparable, it is not difficult to establish a difference in treatment. However, the step to reach this conclusion and thus to actually establish comparability is a more arduous task.

4.1.1. Comparability of Situations

The determination of unequal treatment/discrimination requires a comparison of two situations and their similarity. This in turn requires the preliminary identification of a *tertium comparationis*. The next step is then to select the criteria used to distinguish between two subjects who possess this *tertium comparationis*. Nationality is the relevant criterion for prohibited discrimination. Hence, in the case of direct discrimination, this is straightforward; in the case of indirect discrimination, an assessment of the practical effects of a measure is required.[576] The Court has interpreted indirect discrimination broadly to identify measures that have the same effect as those that discriminate on grounds of nationality. It usually compares a cross-border situation with a domestic situation by comparing a person who acts cross-border in the exercise of a fundamental freedom with a person who realises an objectively comparable situation purely domestically. The comparison between two cross-border situations is only used when national provisions are intended to cover only such cross-border situations.[577]

In order to determine the comparability of situations, the Court often uses the objective of the national measure to have a context and area specific *tertium comparationis*.[578] However, the Court also occasionally refers to the exercise of taxing power by a MS, i.e. whether a resident and a non-resident were both liable to tax in the MS concerned.[579] This approach is therefore based more on the tax treatment and thus on the legal situation of the taxpayer. Probably the

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[575] Eg Case C-279/93 *Schumacker* [1995] ECR I-225, para 20; Case C-374/04 *Test Claimants in Class IV of the ACT Group Litigation* [2006] ECR I-11673, Opinion of AG Geelhoed, para 34; see also Ben Terra and Peter Wattel, *European Tax Law, Fiscale Handboeken* (2nd edn, Kluwer Law International 2012) 59-64.
[576] Pedro Caro de Sousa, 'The Concept of Restriction on Free Movement – An Introduction' in Pedro Caro de Sousa (ed), *The European Fundamental Freedoms* (OUP 2015) 91-92.
[577] Jochen Bahns and others, 'Vorbemerkung zu den Artikeln 110 bis 113 AEUV' in Hans von der Groeben, Jürgen Schwarze and Armin Hatje (eds), *Europäisches Unionsrecht* (7th edn, Beck 2015) paras 26-28.
[578] One such objective could be the removal of tax obstacles arising from the organisation of companies in a group; eg Case C-337/08 *X Holding* [2010] ECR I-1215, para 22; Case C-650/16 *Bevola and Jens W. Trock* [2018] ECLI:EU:C:2018:424, para 32, in that case, however, the Court also stated in para 34 that it is not always necessary to look at the purpose of the national provision in question.
[579] Eg Case C-270/83 *Commission v France* [1986] ECR 273; Case C-48/13 *Nordea Bank Danmark* [2014] ECLI:EU:C:2014:2087; Case C-405/18 *AURES Holdings* [2020] ECLI:EU:C:2020:127.

most comprehensive standard applied by the Court so far is that the companies compared were seeking the same tax advantage and were therefore in comparable situations.[580] This in turn is an approach that links the legal treatment with the comparison of the factual circumstances. However, resorting to such a broad standard would mean that situations are always comparable. This was also criticised by AG Kokott.[581]

The Court distinguishes between residents and non-residents (vertical comparability) and assumes that they are generally not in a comparable situation, so that a difference in treatment is not per se discrimination.[582] However, it may occasionally happen that such situations are comparable, in which case the fundamental freedoms apply. Here, the Court examines the factual circumstances to determine whether they are in fact in a comparable situation, i.e. the Court examines where the non-resident earns the majority of his or her income.[583] The principle of non-discrimination requires that once situations are found to be comparable, they must be treated equally. This would be the case, for example, if a taxpayer is not a resident of the State in which he earns all his income. He is therefore objectively comparable to a resident with regard to income tax. This is because both are taxed only in that one State and the tax base is the same. Thus, if the non-resident is treated differently for tax purposes, his personal situation is not taken into account either by the State of professional activity (non-resident) or by the State of residence (no income). This leads to a disadvantage.[584] It should be noted that the Court does not consider the severity of the disadvantage as a relevant factor, but instead rules that any (minor) disadvantage is contrary to equal treatment.[585]

Similar to the rules on State aid, the ECJ also refers to the objective of the measure within the framework of the fundamental freedoms in order to determine the comparability of situations. When the comparison is made with regard to the objective of a national measure, both the

[580] Case C-337/08 *X Holding* [2010] ECR I-1215, which found that companies wishing to form a tax group with other resident companies are in a comparable situation to companies wishing to form a group with non-resident companies.

[581] Eg Case C-123/11 *A* [2012] ECLI:EU:C:2012:488, Opinion of AG Kokott, para 40; Case C-48/13 *Nordea Bank Danmark* [2014] ECLI:EU:C:2014:2087, Opinion of AG Kokott, paras 24-25; see also Dominik Freyer, 'The Proportionality Principle under EU Tax Law: General and Practical Problems Caused by Its Extensive Application – Part 2' (2017) 57(10) European Taxation 428.

[582] Case C-279/93 *Schumacker* [1995] ECR I-225, paras 31ff; by contrast, horizontal comparability takes place between different residents earning foreign income or different non-residents earning domestic income; see also Michael Lang, 'Recent Case Law of the ECJ in Direct Taxation: Trend, Tensions and Contradictions' (2009) EC Tax Review 104; Markus Mittendorfer and Mario Riedl, 'The Comparability Analysis of the Court of Justice of the European Union in the Light of the Aures Case' (2021) EC Tax Review 166, 168ff.

[583] Eg Case C-279/93 *Schumacker* [1995] ECR I-225, para 36.

[584] Cf Case C-80/94 *Wielockx* [1995] ECR I-2493, paras 21-22.

[585] Eg Case C-270/83 *Commission v France* [1986] ECR 273, para 21.

factual and legal circumstances appear to be taken into account. This is particularly the case when it comes to the tax treatment of situations or taxpayers.

In cases where no discrimination is found due to the lack of comparability, the assessment ends. An example of such cases is *Schumacker*, where it was held that non-residents and residents are not comparable, as the former are only taxable on income earned in the MS, while the latter are subject to full tax liability.[586] In *Truck Center* and *Test Claimants in the Class IV ACT Group*, non-resident creditors and shareholders were held not to be comparable to resident creditors and shareholders as they were not subject to domestic corporate income tax.[587] In *The Bean House*, which concerned the waiver of gift and inheritance tax for rural properties located in the Netherlands that met certain criteria, the Court held that foreign cultural and historical heritage is not objectively comparable to domestic cultural and historical heritage.[588]

An example of a case where the comparability of situations was assessed twice as a separate comparability step and under the justification analysis, was *National Grid Indus* on exit tax. First, the Court considered emigrants and non-emigrants to be comparable with regard to the taxation of capital gains made before the transfer of the place of management, but at the justification level, it rightly held that they are not comparable because of the transfer and thus the cessation of the realisation of profits in the MS of origin.[589] This conclusion seems plausible, as the loss of tax jurisdiction can never be truly comparable to the retention of tax jurisdiction. What does not seem plausible, however, is that the Court considered the situation of emigrants and non-emigrants to be comparable per se.

The following analysis of case law will further clarify how the ECJ approaches the comparability step. What is striking here is that it has a different approach to the various fundamental freedoms. However, it is undisputed that comparability as a precondition for the existence of discrimination is at the heart of the test. For some fundamental freedoms, this step is only carried out during the justification assessment.

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[586] Case C-279/93 *Schumacker* [1995] ECR I-225, paras 28-35, it should be noted that the analysis was continued in this case, as the ECJ addressed the question of the extent to which the situation changes as soon as the non-resident earns little or no income in the country of residence from para 36 onwards.

[587] Case C-282/07 *Truck Center* [2008] ECR I-10767, paras 35-50; Case C-374/04 *Test Claimants in Class IV of the ACT Group Litigation* [2006] ECR I-11673, paras 58-68.

[588] Case C-133/13 *Q* [2014] ECLI:EU:C:2014:2460, paras 21-28; see also Peter Wattel, 'Non-Discrimination *à la Cour*: The ECJ's (Lack of) Comparability Analysis in Direct Tax Cases' (2015) European Taxation 542.

[589] Case C-371/10 *National Grid Indus* [2011] ECR I-12273, paras 38 and 46-52.

4.1.2. Justification and Proportionality

Where discrimination or a restriction of objectively comparable situations has been established, there is the possibility of justification. As in State aid law, the fundamental freedoms in the area of direct taxation are based on the idea that MS must be able to raise tax revenue and enforce their tax policies without impeding free movement in the internal market. A distinction is made between the grounds for justification expressly provided for in the Treaties and the grounds for justification developed by the Court in its case law. If a restriction constitutes direct discrimination on grounds of nationality, it falls under the prohibition of the Treaty and can only be justified by MS on grounds of public policy, public security and public health.[590] However, the possible justifications for indirect discrimination are broad and are not limited to the exceptions set out in the Treaty or secondary legislation, but can be based on overriding reasons of general interest (also referred to as rule of reason).[591] Examples of such unwritten grounds for justification include the fight against tax evasion,[592] effective tax supervision,[593] the principle of territoriality,[594] the balanced allocation of taxing powers[595] and the coherence of the tax system.[596] Since infringements of fundamental freedoms are easily detected among the comparators of the Court, the Court allows a wide range of justifications in order to safeguard the MS' tax sovereignty. Reasons, which have been rejected by the Court include the preservation of tax revenues,[597] the compensation of a tax advantage (in another field),[598] a restriction deriving from a DTC[599] and economic policy objectives.[600]

Underlying all these justificatory reasons of general interest is the requirement that the measures and rules adopted by MS must be suitable for achieving the objective pursued and must not go beyond what is necessary for that purpose. If less burdensome means are available to achieve the overriding general interest objective pursued, the discriminatory measure is not necessary and cannot be justified. In this respect, the ECJ has begun to apply a coherence test as part of the proportionality test. In doing so, the Court requires that a national rule that leads to a

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[590] Arts 45(3), 52, 62 and 65 TFEU.

[591] Peter Wattel and Ben Terra, *European Tax Law* (5th edn, Kluwer Law International 2008) 49; María Cruz Barreiro Carril, 'National Tax Sovereignty and EC Fundamental Freedoms: The Impact of Tax Obstacles on the Internal Market' (2010) 38(2) Intertax 105.

[592] Eg Case C-72/09 *Établissements Rimbaud* [2010] ECR I-10659, paras 33ff.

[593] Eg Case C-233/09 *Dijkman and Dijkman-Lavaleije* [2010] ECR I-6649, para 58.

[594] Eg Case C-250/95 *Futura Participations and Singer* [1997] ECR I-2471, para 22.

[595] Eg Case C-436/08 *Haribo Lakritzen Hans Riegel* [2011] ECR I-305, para 121.

[596] Eg Case C-204/90 *Bachmann* [1992] ECR I-249, para 28.

[597] Eg Case C-264/96 *Imperial Chemical Industries v Colmer* [1998] ECR I-4695, para 28.

[598] Eg Case C-107/94 *Asscher* [1996] ECR I-3089, paras 51-53.

[599] Eg Case C-307/97 *Saint-Gobain ZN* [1999] ECR I-6161, paras 54-62.

[600] Eg Case C-35/98 *Verkooijen* [2000] ECR I-4071, paras 47-48.

restriction of a fundamental freedom must fulfil the objective it pursues in a coherent and systematic manner. In this way, the Court aims to find the necessary flexibility to reconcile the competences and sovereignty of the MS with the objectives of the internal market.[601]

An illustrative example of a measure that could be justified but failed the proportionality test is the *ELISA* case, which involved the imposition of a tax on the commercial value of immovable property owned by legal persons in France. The question at issue in the reference for a preliminary ruling was whether the freedom of establishment and the free movement of capital preclude legislation which grants a right to tax exemption to legal persons having their place of effective management in France and makes that right conditional, for legal persons having their place of effective management in another country, on the existence of an agreement on administrative assistance to combat tax evasion and avoidance between France and that other State or on the existence of a treaty under which such companies may not be taxed more heavily than companies established in France.[602] The applicant ELISA, a holding company incorporated under Luxembourg law, acquired immovable property in France. The Court held that the freedom of establishment was not applicable, only the free movement of capital, since ELISA merely owned property in France without carrying on any economic activity there. As no convention had been concluded between France and Luxembourg by that time to deal with double taxation issues, the applicant was not exempt from tax. Since only States can conclude conventions, legal persons in such situations are de facto permanently exempt from tax, which makes investment in immovable property in France less attractive to non-resident companies. The Court considered this to be a restriction on the free movement of capital. It then examined possible justifications and confirmed that the prevention of tax evasion is an overriding requirement in the general interest. This justification relates exclusively to wholly artificial arrangements. With regard to proportionality, the Court noted that the tax authorities could have requested evidence from the taxpayer that the tax had been correctly assessed before refusing the exemption. Thus, that legislation completely prevented companies from proving that their objective is not tax evasion. After this examination, the Court concluded that the measure was not justified, as the objective of combatting tax evasion could have been achieved by less restrictive measures.[603] The importance of the fourth step should not be underestimated. Just

[601] Eg Case C-153/08 *Commission v Spain* [2009] ECR I-9735, para 38; for more on coherence see Juliane Kokott and Hartmut Ost, 'Europäische Grundfreiheiten und nationales Steuerrecht' (2011) EuZW 496, 502.
[602] Case C-451/05 *ELISA* [2007] ECR I-8251, para 18.
[603] Case C-451/05 *ELISA* [2007] ECR I-8251, paras 56-102; similarly Case C-196/04 *Cadbury Schweppes and Cadbury Schweppes Overseas* [2006] ECR I-7995.

because a measure is justified in relation to its objective does not mean that it passes the fundamental freedoms test. Any legitimate reason must also be implemented proportionately.

Although the steps of the non-discrimination test applied by the Court seem straightforward, their application is not. As will be seen in the following sections, the Court applies the test in a methodologically inconsistent manner when it comes to the various freedoms.

4.2. The General Principle of Equal Treatment and Non-Discrimination

The most basic right in free movement, and one of the fundamental principles of EU law, is that there shall be no (direct) discrimination based on nationality pursuant to Art 18 TFEU.[604] The terms 'principle of equal treatment' and 'principle of non-discrimination' are used synonymously.[605] This general EU law principle of equality requires that similar situations may not be treated differently unless differentiation is objectively justified. Conversely, situations that are objectively different may be treated as such.[606] The principle of equal treatment does however not concern differences of treatment resulting from divergences between the laws of the MS, as long as they affect all persons and undertakings equally on the basis of objective criteria and without regard to their nationality or place of establishment.[607] Beyond its central function as a directly applicable guarantee of equality, Art 18 TFEU is also important as an overarching interpretative framework of EU law and the specific prohibitions of discrimination.[608]

Even though Art 18 TFEU applies principally in relation to MS, it is by nature a fundamental right. According to settled case-law, it is a particular expression of the general principle of equality, since it relates to nationality.[609] The fundamental right character of Art 18(1) TFEU is

[604] Additionally, Art 21(1) CFR prohibits discrimination based on sex, race, colour, ethnic or social origin etc; Arts 2 and 3 TEU and Arts 8 and 10 TFEU identify non-discrimination as a core value and provision of general application of the EU.
[605] Case C-422/02 P *Europe Chemi-Con (Deutschland) v Council* [2005] ECR I-791, para 33.
[606] Case C-13/63 *Italy v Commission of the EEC* [1963] ECR 337; since then, established case law, eg Case C-117/76 *Ruckdeschel* [1977] ECR 1753, para 7; Case C-522/20 *OE (Résidence habituelle d'un époux – Critère de nationalité)* [2022] ECLI:EU:C:2022:87, para 19; see also Mattias Wendel, 'Art 18 AEUV' in Eberhard Grabitz, Meinhard Hilf and Martin Nettesheim (eds), *Das Recht der Europäischen Union* (83th edn, Beck 2024) paras 3-4.
[607] Denis Martin, 'Article 18 TFEU' in Manuel Kellerbauer, Marcus Klamert and Jonathan Tomkin (eds), *The EU Treaties and the Charter of Fundamental Rights: A Commentary* (OUP 2009) 420.
[608] It has a panoptic character, serving as both a guarantee and a compass, see Mattias Wendel, 'Art 18 AEUV' in Eberhard Grabitz, Meinhard Hilf and Martin Nettesheim (eds), *Das Recht der Europäischen Union* (83th edn, Beck 2024) para 8.
[609] Eg Case C-810/79 *Überschär* [1980] ECR 2747, para 16; Case C-186/87 *Cowan v Trésor public* [1989] ECR 195, paras 10ff; Case C-115/08 *CEZ* [2009] ECR I-10265, para 89; Case C-581/18 *TÜV Rheinland LGA Products and Allianz IARD* [2020] ECLI:EU:C:2020:453, paras 32-36; Mattias Wendel, 'Art 18 AEUV' in Eberhard Grabitz, Meinhard Hilf and Martin Nettesheim (eds), *Das Recht der Europäischen Union* (83th edn, Beck 2024) para 9.

reflected in Art 21(2) CFR.[610] The notion of nationality is to be understood in the broader sense and includes both the nationality of natural and legal persons. The comparability of the factual situations of nationals and non-nationals concerned is a relevant factor.[611] The ECJ has stated that the comparability of the various situations must be assessed by reference to all the factors distinguishing them, which must be determined and assessed in light of the subject matter, purpose and principles of the rules governing the measure concerned.[612] Art 18(1) TFEU covers direct (overt) and indirect (covert) discrimination.[613] A rule discriminates directly if it explicitly differentiates on the basis of nationality or fails to make this necessary distinction (e.g. preferential treatment of nationals). Indirect discrimination occurs when the measure is not formally based on nationality, but the result is the same, i.e. non-nationals are treated less favourably or differently than nationals, and this cannot be justified.[614] The application of other distinguishing criteria thus achieves the same result as a formal link to nationality.[615]

The provision is only applied as a stand-alone basis if the Treaty does not provide for specific prohibitions of discrimination.[616] It is further specified by the fundamental market freedoms, as *leges speciales*, in their respective areas of application. Any provision of national law that conflicts with the fundamental freedoms therefore also violates the general prohibition of discrimination in Art 18 TFEU.[617]

A well-known case in which the Court assessed a measure under Art 18 TFEU, although Arts 34 and 56 TFEU were also at stake, is the action brought by Austria against Germany concerning the introduction of an infrastructure use charge for passenger cars and the exemption from motor vehicle tax in the amount of this charge for the owners of vehicles registered in Germany. When the Commission decided to terminate the infringement procedure against Germany, Austria alleged a violation of Art 18 TFEU via Art 259 TFEU. Austria asserted that German nationals were favoured over nationals of other MS in that all users of Germany motorways were subject to the infrastructure use charge, but the owners of vehicles registered in Germany

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[610] Cf Case C-550/07 P *Akzo Nobel Chemicals and Akcros Chemicals v Commission* [2010] ECR I-8301, para 54; Case C-703/17 *Krah* [2019] ECLI:EU:C:2019:850, para 18.

[611] Mattias Wendel, 'Art 18 AEUV' in Eberhard Grabitz, Meinhard Hilf and Martin Nettesheim (eds), *Das Recht der Europäischen Union* (83th edn, Beck 2024) paras 16-17.

[612] Eg Case C-522/20 *OE (Résidence habituelle d'un époux – Critère de nationalité)* [2022] ECLI:EU:C:2022:87, para 20.

[613] Eg Case C-22/80 *Boussac v Gerstenmeier* [1980] ECR 3427, para 9.

[614] Mattias Wendel, 'Art 18 AEUV' in Eberhard Grabitz, Meinhard Hilf and Martin Nettesheim (eds), *Das Recht der Europäischen Union* (83th edn, Beck 2024) paras 25 and 29.

[615] Eg Case C-22/80 *Boussac v Gerstenmeier* [1980] ECR 3427, para 9.

[616] Cf Case C-311/08 *SGI* [2010] ECR I-487, para 31.

[617] Case C-384/08 *Attanasio Group* [2010] ECR I-2055, para 31; Jochen Bahns and others, 'Vorbemerkung zu den Artikeln 110 bis 113 AEUV' in Hans von der Groeben, Jürgen Schwarze and Armin Hatje (eds), *Europäisches Unionsrecht* (7th edn, Beck 2015) para 13.

were exempt from the motor vehicle tax in the amount of the charge, so that the economic burden de facto only affected the owners and drivers of vehicles registered in a State other than Germany.[618] Interestingly, AG Wahl concluded that the owners of German vehicles, who as German taxpayers benefit from the tax relief, and the owners of foreign vehicles, who are subject to other taxes in their own country, are not comparable. Proceeding nevertheless to a comparability analysis, the AG found that the owners of foreign vehicles could never be placed in a situation less favourable than the owners of domestic vehicles, as German vehicle owners would have to pay a higher or equivalent amount via the annual infrastructure use charge despite the tax relief.[619] Taking into account taxes that apply to foreign vehicles makes neither legal nor practical sense, which is probably why the Court decided otherwise.

The ECJ disagreed and found the tax relief inherently linked to the infrastructure use charge. It confirmed the difference in treatment between keepers of vehicles registered in Germany and those registered abroad, finding that they are in a comparable situation with regard to the use of German motorways. Although the unequal treatment was not directly based on nationality, the Court found that the majority of owners of vehicles registered abroad are not German nationals, while the majority of owners of vehicles registered in Germany are German nationals, which in fact leads to the same outcome as a difference in treatment based on nationality. This finding was not affected by Germany's argument that German vehicle keepers have to pay both the infrastructure use charge and the motor vehicle tax and that the amount paid by foreign vehicle owners is equal to the amount paid by German owners.[620] Hence, according to the Court, the

> "movement to a system of financing based on the 'user pays' and 'polluter pays' principles in reality affects exclusively the owners and drivers of vehicles registered in Member States other than Germany, whereas the principle of financing by means of taxation continues to apply with respect to owners of vehicles registered in Germany".[621]

In justification, Germany argued that the measures were based on considerations relating to environmental protection, the distribution of the burden between German and foreign users in order to preserve the coherence of the national tax system and the modification of the system for financing infrastructure. The Court found that Germany had not demonstrated how the

[618] Case C-591/17 *Austria v Germany* [2019] ECLI:EU:C:2019:504, paras 37-48.
[619] Case C-591/17 *Austria v Germany* [2019] ECLI:EU:C:2019:99, Opinion of AG Wahl, paras 46-58.
[620] Case C-591/17 *Austria v Germany* [2019] ECLI:EU:C:2019:504, paras 49ff.
[621] Case C-591/17 *Austria v Germany* [2019] ECLI:EU:C:2019:504, para 68.

introduction of an infrastructure use charge affecting only foreign owners was appropriate to achieve those objectives and therefore considered that it had failed to fulfil its obligations under Art 18 TFEU.[622] It is the combined application of the general and specific non-discrimination provisions that makes this case so remarkable. One possible explanation could lie in the procedural differences between preliminary references and infringement proceedings. However, applying the different provisions did not change the result obtained. Since the Court found the German measures to be discriminatory, they violated not only Art 18 TFEU, but also Arts 34 and 56 TFEU, which are specific manifestations of the general prohibition of discrimination.[623] However, this was an exceptional case; as a rule, reference is only made to the more specific provisions of the fundamental freedoms.

4.3. The Treaty's Fundamental Freedoms

The Treaty provisions on workers, services and establishment each require equal treatment for persons exercising their freedom of movement and establishing themselves in a MS, the only difference being that in the former case they exercise their freedom of movement in their capacity as employed persons and in the latter two cases in their capacity as self-employed persons.[624]

Fundamental freedoms and equal treatment prohibit not only forms of direct/overt discrimination based on nationality, but also all covert/indirect forms that lead to the same de facto result through the application of other distinguishing criteria such as residence.[625] Applied to companies, the connecting factor for establishing discrimination is the registered office or seat, similar to nationality in the case of natural persons.[626] Discrimination occurs when different rules are applied to comparable situations or when the same rule is applied to different situations (unless such treatment is objectively justified).[627] Statutory definitions of indirect discrimination were later added in secondary legislation dealing with various forms of discrimination. Examples are Art 2 of Directive 2000/43/EC implementing the principle of

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[622] Case C-591/17 *Austria v Germany* [2019] ECLI:EU:C:2019:504, paras 73-78; another of Austria's arguments for a possible violation of Art 18 TFEU concerned the random checks on the payment of the charge and the associated payment of fines. However, the Court found that Austria could not prove a difference in treatment and ruled that even in the case of unequal treatment, it would be justified to ensure the payment of the charge and the fine.

[623] Cf Augustin Chapuis-Doppler and Vincent Delhomme, 'Non-discrimination and free movement in a Member State fiscal dispute: Case C-591/17 Austria v Germany' (2019) 26(6) Maastricht Journal of European and Comparative Law 849.

[624] Cf Case C-268/99 *Jany and Others* [2001] ECR I-8615.

[625] Eg Case C-175/88 *Biehl* [1990] ECR I-1779, paras 13-14.

[626] Eg Case C-270/83 *Commission v France* [1986] ECR 273, para 18; Case C-330/91 *Commerzbank* [1993] ECR I-4017, paras 14-15; Case C-279/93 *Schumacker* [1995] ECR I-225, para 26.

[627] Eg Case C-311/97 *Royal Bank of Scotland* [1999] ECR I-2651, para 26 and the case law cited.

equal treatment between persons irrespective of racial or ethnic origin, Art 2 of Directive 2000/78/EC establishing a general framework for equal treatment in employment and occupation or Art 2 of Directive 2006/54/EC on the implementation of the principle of equal opportunities and equal treatment of men and women in matters of employment and occupation (recast), which provide that indirect discrimination arises where an apparently neutral provision, criterion or practice would put persons of one sex/age/etc at a disadvantage compared with persons of the other sex/etc, unless objectively justified by a legitimate aim and appropriate and necessary measures.[628]

According to the case law, the fundamental freedoms contain not only a prohibition of discrimination, but also a prohibition of restrictions. Accordingly, the fundamental freedoms preclude national provisions which, although applicable without discrimination on grounds of nationality, prohibit, impede or render less attractive the exercise of the fundamental freedoms.[629] For this purpose, it is sufficient that the exercise of a fundamental freedom is less attractive without having to prove that the measure or regulation actually has this effect.[630] Direct taxes raise a number of specific issues in the context of the right to free movement, as those rules are territorial by nature. The imposition of any tax renders the exercise of the free movement rights less attractive. For this reason, the Court resorts to a non-discrimination test for direct tax cases. Accordingly, the situation of residents and non-residents is often compared. If they are not objectively comparable, there is no discriminatory treatment.

The ECJ regularly rules on the compatibility of national measures with regard to more than one fundamental freedom. In such cases, the Court limits its examination to the most relevant freedom after having examined the objective of the measure.[631] However, if the fundamental freedoms are considered equally important and relevant, the Court may address each of them in its reply.[632] The areas of application of the fundamental freedoms may overlap and converge. Due to the basic uniform dogma applied by the Court to protect cross-border activities and to provide for a level of justification, it does not matter which fundamental freedom is applied to a situation. Thus, if a violation of one freedom is found, it is no longer necessary to examine another freedom, as the conclusions drawn from the examination of one fundamental freedom

[628] Cf Nigel Foster, *Foster on EU Law* (4th edn, OUP 2013) 280-281.
[629] Eg Case C-19/92 *Kraus* [1993] ECR I-1663, para 32.
[630] Eg Case C-524/04 *Test Claimants in the Thin Cap Group Litigation* [2007] ECR I-2107, para 62.
[631] Case C-356/08 *Commission v Austria* [2009] ECR I-108, para 32.
[632] Jonathan Tomkin, 'Article 56 TFEU' in Manuel Kellerbauer, Marcus Klamert and Jonathan Tomkin (eds), *The EU Treaties and the Charter of Fundamental Rights: A Commentary* (OUP 2019) 710.

also apply to the others.[633] Although national measures and provisions may fall within the scope of several fundamental freedoms, the Court usually does not examine the measure in relation to 'secondary' freedoms.[634]

As will become apparent, the focus of the analysis of the case law will be on the freedom of establishment, as most direct tax cases fall thereunder and therefore provide more information on the systematics of the test. The freedom to provide services is often examined together with the freedom of establishment, the latter usually being the primary fundamental freedom. Therefore, this study refrains from a more in-depth analysis of the freedom to provide services. The methodology of the free movement of workers and the free movement of capital serves as important comparative value. The free movement of goods is of considerable practical relevance, especially as parts of the dogmatics of the fundamental freedoms have developed from it. However, the free movement of goods has hardly played a role in the area of direct taxation. For this reason, it will not be further discussed here. The chapters on the respective freedoms are divided into specific case groups or categories. The cases explained there are listed chronologically, starting with some of the earliest cases in this area, followed by the more recent ones in order to follow the development of the methodology in the case law. Due to the large number of ECJ judgements in this area, not all relevant cases are listed separately. The study is limited to the judgements that the author considers to be the most exemplary. Further details can be found in the footnotes and the cases listed there.

4.3.1. Art 45 TFEU – Free Movement of Workers

According to the Court, Art 45 TFEU intends "to facilitate the pursuit by [EU] citizens of occupational activities of all kinds throughout the [EU], and preclude measures which might place [EU] citizens at a disadvantage when they wish to pursue an economic activity in the territory of another Member State".[635] To this end, the notion of worker is interpreted broadly and given an autonomous meaning in EU law.[636] Art 45 TFEU, constituting a specific application of the general prohibition of discrimination under Art 18 TFEU and a *lex specialis*

[633] Cf eg Case C-118/96 *Safir* [1998] ECR I-1897, para 35.
[634] Case C-374/04 *Test Claimants in Class IV of the ACT Group Litigation* [2006] ECR I-11673, para 38; Case C-42/07 *Bwin International* [2009] ECR I-7633, para 47; Jochen Bahns and others, 'Vorbemerkung zu den Artikeln 110 bis 113 AEUV' in Hans von der Groeben, Jürgen Schwarze and Armin Hatje, *Europäisches Unionsrecht* (7th edn, Beck 2015) paras 47ff.
[635] Case C-464/02 *Commission v Denmark* [2005] ECR I-7929, para 34 and the case law cited.
[636] Art 45(2) TFEU refers to employment and remuneration; for an overview of the features of an employment relationship see Case C-66/85 *Lawrie-Blum* [1986] ECR 2121, paras 16 and 17.

to Art 21 TFEU, takes precedence over any conflicting national rule.[637] Nationals of a MS who are legally established in another MS for the purpose of employment must therefore be treated in the same way as nationals of that other MS.[638] The same holds true for those nationals who have exercised their right of free movement and those who have not.[639]

As far as direct taxes are concerned, the scope of the free movement of workers protects in particular against discriminatory taxation of earned income. Otherwise, the principle of equal treatment in the area of pay would be undermined.[640] Where the difference in tax treatment of persons resident in another MS is not based on relevant differences in the situation of those persons or their taxable assets, such treatment falls within the provisions on the freedom.[641] An example of prohibited discrimination is tax advantages granted by national authorities that unduly favour nationals of certain MS over nationals of other MS (e.g. depending on the distance between the country of residence and the country of employment).[642] In practice, indirect discrimination is much more common, as national legislation makes the granting of benefits or payments conditional on criteria such as place of birth or, in particular, residence on the national territory, so that these benefits are de facto reserved for nationals of MS concerned.[643]

However, there are also many situations where national tax rules that may have an impact on free movement are considered compatible with Art 45 TFEU.[644] This applies in particular to tax disadvantages resulting from differences between national tax laws. Thus, workers cannot expect the relocation of their activity to another MS to be fiscally neutral (e.g. higher income

[637] Case C-118/75 *Watson* [1976] ECR 1185, para 16; see also Manuel Kellerbauer and Denis Martin, 'Article 45 TFEU' in Manuel Kellerbauer, Marcus Klamert and Jonathan Tomkin (eds), *The EU Treaties and the Charter of Fundamental Rights: A Commentary* (OUP 2019) 617.
[638] Case C-137/84 *Mutsch* [1985] ECR 2681, para 12.
[639] See eg Case C-306/03 *Salgado Alonso* [2005] ECR I-705, paras 32-36, the Court refers here to indirect discrimination; see also Manuel Kellerbauer and Denis Martin, 'Article 45 TFEU' in Manuel Kellerbauer, Marcus Klamert and Jonathan Tomkin (eds), *The EU Treaties and the Charter of Fundamental Rights: A Commentary* (OUP 2019) 618.
[640] Case C-175/88 *Biehl* [1990] ECR I-1779, para 12.
[641] Case C-240/10 *Schulz-Delzers and Schulz* [2011] ECR I-8531; Case C-269/09 *Commission v Spain* [2012] ECLI:EU:C:2012:439.
[642] See eg Case C-512/13 *Sopora* [2015] ECLI:EU:C:2015:108, where the formation of horizontal comparators was at issue (comparison of two cross-border situations). The ECJ pointed out that the free movement of workers also prohibits the different treatment of non-resident workers if it leads to an unjustified preference for nationals of certain MS over other nationals. The case concerned employees who did not fulfil the condition of residence at a distance of more than 150 km from the Dutch border.
[643] See eg Case C-237/94 *O'Flynn* [1996] ECR I-2617, para 18; Case C-152/73 *Sotgiu* [1974] ECR 153, para 11; Case C-152/73 *Sotgiu* [1974] ECR 153, Opinion of AG Mayras, pt III.
[644] Case C-9/14 *Kieback* [2015] ECLI:EU:C:2015:406; Case C-602/17 *Sauvage and Lejeune* [2018] ECLI:EU:C:2018:856; Paul Craig and Gráinne de Búrca, *EU Law: Text, Cases, and Materials* (7th edn, OUP 2020) 797.

taxes).[645] Furthermore, the Court has clarified that mobile workers are not necessarily in a comparable situation to non-mobile workers. The same holds true for resident and non-resident taxpayers. Whether or not there is comparability must be defined in light of the objective pursued by the national provisions.[646]

According to Art 45(2) TFEU, discrimination against workers on grounds of nationality cannot be justified unless provided for in the Treaties. Indirectly discriminatory measures, however, may be justified on grounds of public policy, public security or public health, provided that the measure is proportional in the wide and strict sense.[647]

4.3.1.1. ECJ Case Law on the Free Movement of Workers

This chapter examines the ECJ's most important rulings on the free movement of workers, focusing specifically on tax measures that intersect with personal and family circumstances, as well as on pension contributions and the status of frontier workers. These categories were chosen for their central importance in addressing practical challenges faced by mobile workers in the EU, as well as their significance in the broader context of ensuring equal treatment. Furthermore, these are the areas on which the Court has most frequently ruled in this context, as highlighted by the additional case references in the footnotes, which underline the recurring importance of these matters in case law.

Personal and family related tax advantages underline the importance of equal treatment in tax matters, where differences in family status or personal circumstances can lead to discriminatory outcomes. These cases are crucial to understanding how the ECJ applies the principle of non-discrimination in situations involving the financial responsibilities and obligations of employees. The cases on deductibility of pension and annuity contribution address the cross-border implications of tax relief for retirement savings and reflect the tension between national tax sovereignty and the Union's objective of facilitating mobility while preserving the rights of workers. The category of frontier workers represents a unique subset of mobile workers whose lives and income streams span national borders. Tax measures affecting this group often raise complex issues of jurisdiction and equal treatment, making this category critical for the study of the practical application of equal treatment. By analysing representative cases in these

[645] Case C-387/01 *Weigel* [2004] ECR I-4981, para 55.
[646] See eg Case C-20/16 *Bechtel* [2017] ECLI:EU:C:2017:488, paras 53ff.
[647] Art 45(3) TFEU; Manuel Kellerbauer and Denis Martin, 'Article 45 TFEU' in Manuel Kellerbauer, Marcus Klamert and Jonathan Tomkin (eds), *The EU Treaties and the Charter of Fundamental Rights: A Commentary* (OUP 2019) 622ff; an example for an overriding reason in the public interest is the need to ensure the effective recovery of tax, see C-269/09 *Commission v Spain* [2012] ECLI:EU:C:2012:439, para 64.

categories, the chapter aims to provide a comprehensive understanding of how the Court interprets and applies the free movement of workers in relation to tax measures.

(a) Personal and Family Related Tax Advantages: *Schumacker*, *Gschwind*, *Wallentin* and *Kieback*

In the prominent case *Schumacker*, the Court ruled on a case concerning German income tax law, treating taxpayers differently depending on their residence in Germany. Accordingly, persons with permanent residence in Germany were liable to tax on their entire income ('unlimited taxation'), while persons without permanent residence in Germany were liable to tax only on the part of their income earned in Germany ('limited taxation'). Persons subject to unlimited taxation also benefitted from various procedures, such as the annual adjustment of wages tax, in which the employer had to refund part of the withheld wage tax, or the tax advantage they received as married couples. These benefits were not granted to those with limited tax liability.[648] Mr Schumacker, a Belgian national, always lived in Belgium with his wife and children. During a certain period, he was employed in Germany but continued to live in Belgium. According to the double taxation agreement between Germany and Belgium, Germany had the right to tax Mr Schumacker's wages as the State of activity (withholding tax deduction by the employer). Mr Schumacker's application to have his tax calculated on an equitable basis was rejected by the tax authorities. Finally, the German Federal Fiscal Court stayed proceedings and asked the ECJ whether (now) Art 45 TFEU, requiring the abolition of any discrimination based on nationality between workers, restricts Germany's right to levy income tax on a national of another MS.[649]

The Court previously held that the principle of equal treatment in relation to remuneration would be ineffective if it could be undermined by discriminatory provisions on income tax.[650] Again, it emphasised that Art 45 TFEU prevents a MS from treating non-nationals employed in its territory less favourably than its own nationals in the same situation when levying direct taxes.[651] Consequently, tax advantages granted only to residents of a MS may constitute indirect discrimination on grounds of nationality, but this is not necessarily the case, as the Court clarified that the situation of residents and non-residents is in principle not comparable.[652] The situation is different, however, if the non-resident does not earn his or her income, or earns it

[648] Case C-279/93 *Schumacker* [1995] ECR I-225, paras 1-14.
[649] Case C-279/93 *Schumacker* [1995] ECR I-225, paras 15-19.
[650] Case C-175/88 *Biehl* [1990] ECR I-1779, para 12.
[651] Case C-279/93 *Schumacker* [1995] ECR I-225, para 24.
[652] Case C-279/93 *Schumacker* [1995] ECR I-225, paras 29-34.

only to a small extent, in the State of residence but in the State of employment, with the result that the State of residence cannot grant him or her benefits with regard to personal and family circumstances. The non-resident is thus discriminated against by the fact that neither the State of residence nor the State of employment take his or her personal and family circumstances into account when calculating tax.[653] The Court then proceeded to the justification analysis for the discrimination. The justification of administrative burdens or the need for cohesion of the tax system put forward by the MS could not be upheld.[654] The Court also noted that the Dutch-German double taxation agreement provides for the taking into account of the personal and family circumstances of Dutch frontier workers who reside in the Netherlands and work in Germany, provided that they receive at least 90% of their income in Germany.[655] The less favourable treatment of Mr Schumacker was therefore unjustifiable and contrary to Art 45 TFEU.[656]

The *Gschwind* case dealt with a Dutch national and resident who was employed in Aachen, whilst his wife worked in the Netherlands. According to the double taxation agreement between Germany and the Netherlands, Mr Gschwind's income was taxable in Germany and his wife's in the Netherlands. The German tax administration assessed Mr Gschwind as unlimited taxpayer but treated him as a non-married person. The German Law on Income Tax (*Einkommensteuergesetz*) grants spouses resident in Germany the tax benefit of splitting, but makes such granting for non-residents conditional on at least 90% of their worldwide income being subject to tax in that State or, if the percentage is not reached, that the foreign income does not exceed a certain amount.[657] According to the ECJ, such a rule is compatible with EU law, since residents of a MS and non-residents are generally not in a comparable situation. The fact that a MS does not grant the same tax benefits to non-residents as to residents is not discriminatory having regard to the objective differences between their situations regarding the source of income and the ability to pay tax or their personal and family circumstances. The income received by a non-resident is usually only a part of his total income being concentrated at his place of residence, the place where his personal and financial interests are centred.[658]

[653] Case C-279/93 *Schumacker* [1995] ECR I-225, paras 36-38.
[654] Case C-279/93 *Schumacker* [1995] ECR I-225, paras 39-46.
[655] Case C-279/93 *Schumacker* [1995] ECR I-225, para 46.
[656] Similarly, Case C-87/99 *Zurstrassen* [2000] ECR I-3337; cf Erik Ros, *EU Citizenship and Direct Taxation* (Kluwer Law International 2017) 217ff.
[657] Case C-391/97 *Gschwind* [1999] ECR-I5451, paras 3-11.
[658] Case C-391/97 *Gschwind* [1999] ECR-I5451, paras 22, 23, 30 and 32; similarly Case C-107/94 *Asscher* [1996] ECR I-3089 (ultimately assessed under the freedom of establishment due to the self-employment of Mr Asscher); Case C-385/00 *de Groot* [2002] ECR I-11819.

Wallentin concerned the imposition by Sweden of a special tax on the income of non-residents. Mr Wallentin, a German national and resident, received a monthly payment from his parents and the German State for his studies, which did not constitute taxable income. He went to Sweden for a short period to do a remunerated internship and applied for exemption from income tax on this amount, which was refused by the Swedish tax authorities. According to the Swedish law in question, the special income tax of 25% applies to persons resident abroad who receive income in Sweden during short stays of no more than six months a year. The basic allowance is thus only granted in full to taxpayers who reside in Sweden for a full tax year. Mr Wallentin considered that the granting of the basic allowance only to full taxpayers, and not to limited taxpayers, constituted discrimination prohibited by Art 45 TFEU. In contrast, the Swedish, French and Finnish governments took the view that the situation of these two groups was not comparable.[659]

The Court agreed that, in principle, residents and non-residents are not in a comparable situation, but also noted that this is different in cases where non-residents do not earn significant income in their State of residence, but only in the State of employment, so that the State of residence is not able to take into account the personal and family circumstances. If the State of employment does not do so either, the person concerned is discriminated against. Mr Wallentin had no taxable income in the State of residence. Moreover, the Court reiterated its conclusion from the *Gerritse* judgment,[660] in which it had held that the basic allowance pursues a social purpose to ensure taxpayers a tax-free subsistence minimum, and concluded that this also applies to Swedish law. It follows that not granting an allowance to limited taxpayers who do not earn income in their State of residence constitutes discrimination prohibited by Art 45 TFEU. The argument that such an allowance would undermine the cohesion of the tax system cannot be upheld. The State of employment must take into account the family and personal circumstances of non-residents in the same way as that of residents.[661]

Kieback concerned the refusal of the Dutch tax authorities to deduct expenditure on the repayment of a mortgage-backed loan taken out for the acquisition of a dwelling located in Germany. Mr Kieback, a German national and resident employed in the Netherlands, was the owner of a flat in Germany. In the tax year in question, Mr Kieback earned most of his income in the US and the Dutch authorities therefore taxed him on the income earned in the Netherlands

[659] Case C-169/03 *Wallentin* [2004] ECR I-6443, paras 1-14.
[660] Case C-234/01 *Gerritse* [2003] ECR I-5933, para 48.
[661] Case C-169/03 *Wallentin* [2004] ECR I-6443, paras 15-24; see also Case C-544/11 *Petersen* [2013] ECLI:EU:C:2013:124, concerning the tax exemption of income from work carried out in another State in the context of development aid.

for that year, without taking into account the negative income relating to his flat. Following Mr Kieback's action, the Hoge Raad finally decided to stay proceedings and to refer to the Court for a preliminary ruling the question whether a MS must take into account personal and family circumstances where the taxpayer has worked in that MS for only a part of the year while residing in another MS, and has earned all or most of his income in the State of employment (but not in a particular year), but has moved to another (non-EU) State to work and live there.[662]

The Court noted at the outset that taxpayers resident in the Netherlands have the possibility of taking into account negative income from dwellings situated in the Netherlands, a treatment which favours residents over non-residents. It also noted that the taking into account of negative income from immovable property located in the MS of residence constitutes a tax advantage linked to the taxpayer's personal situation. It then examined the comparability of the situation of residents and non-residents and found that non-residents who did not receive all or most of their income in the State of employment during the year in question are not in a comparable situation to residents of that State. If a taxpayer pursues his professional activity elsewhere, the State of residence may continue to take into account the total income and the personal and family circumstances. It cannot be assumed that the State of previous employment can assess the taxpayer's situation better than the State to which the person has moved. That MS is therefore not obliged to grant the taxpayer the same advantages as those granted to its residents. The fact that the worker has moved away to take up employment in a third State does not alter this conclusion.[663]

It can be discerned from the case law that the personal and family circumstances of the taxpayer must be taken into account somewhere in order to allow economically active EU citizens to carry out economic activity in a cross-border context.

(b) Deductibility of Pension and Annuity Contributions: *Kohll and Kohll-Schlesser*

Mr Kohll and his wife Mrs Kohll-Schlesser, both nationals and residents of Luxembourg, received pensions from the Netherlands. Under Luxembourg law, all taxpayers who receive pensions or annuities are granted a tax credit on their income, provided that Luxembourg has the right of taxation and the taxpayer is in possession of a tax deduction form. The applicants complained that the Luxembourg tax authorities did not grant them the tax credit. While Mrs Kohll's claim was declared inadmissible, the referring court argued that Mr Kohll had not been

[662] Case C-9/14 *Kieback* [2015] ECLI:EU:C:2015:406, paras 1-15.
[663] Case C-9/14 *Kieback* [2015] ECLI:EU:C:2015:406, paras 16-36; see also Case C-241/20 *Belgian State (Perte d'avantages fiscaux dans l'État membre de résidence)* [2021] ECLI:EU:C:2021:605.

issued with a tax deduction form required to claim the tax credit, which could lead to indirect discrimination. It therefore stayed the proceedings and referred to the Court the question whether a law limiting entitlement to a tax credit to persons possessing a tax deduction form was contrary to Art 45 TFEU.[664]

The Court first considered the applicability of Art 45 TFEU, as the applicants were, strictly speaking, no longer workers but retired. However, as Mr Kohll had taken up employment in another MS, he exercised his right to free movement under Art 45 TFEU. Since pension entitlement is inextricably linked to the status of worker, the fact that a person is no longer in an employment relationship cannot deprive him of certain guaranteed rights. The situation of a person who receives a pension for an activity pursued in a MS other than the MS of residence is different from the situation of a person who has spent his entire working life in his MS of origin and who exercises his right to reside in another MS only after retirement and who cannot therefore rely on Art 45 TFEU.[665] Thus, Mr Kohll's situation fell within the scope of Art 45 TFEU. If, on the other hand, it were found that the pension did not depend on the person's status as a worker, but on the fact that he resided in the Netherlands, Art 21 TFEU could be invoked. The Court therefore considered both Arts 21 and 45 TFEU to be applicable.[666] With regard to Art 45 TFEU, the Court found a restriction in that taxpayers resident in Luxembourg are treated differently depending on the MS from which they draw their retirement pension and that taxpayers who draw their pension from a MS other than Luxembourg are denied the tax credit, thereby discouraging workers from seeking employment in another MS. With regard to Art 21 TFEU, the Court held that national legislation which discriminated against certain nationals solely because they have exercised their freedom of movement constitutes a restriction, as in the present case.[667]

Only at the level of justification did the Court expressly examine the comparability of the situations in the light of the objective pursued by the legislation. According to Luxembourg, the tax credit was introduced in order to pursue a selective tax policy in favour of persons from socially vulnerable backgrounds by allowing them to have a higher disposable income. However, the Court held that a resident taxpayer who receives his pension from another MS is not necessarily in a different situation, since both categories of taxpayer may belong to

[664] Case C-300/15 *Kohll and Kohll-Schlesser* [2016] ECLI:EU:C:2016:361, paras 1-18.
[665] Cf Case C-632/13 *Hirvonen* [2015] ECLI:EU:C:2015:765, where the situation was not covered by Art 45 TFEU because the person exercised her right to free movement only after retirement, but which was covered by Art 21 TFEU (right to free movement as an EU citizen).
[666] Case C-300/15 *Kohll and Kohll-Schlesser* [2016] ECLI:EU:C:2016:361, paras 20-35.
[667] Case C-300/15 *Kohll and Kohll-Schlesser* [2016] ECLI:EU:C:2016:361, paras 36-44.

vulnerable groups. The Luxembourg government put forward two justifications in this context: preserving the cohesion of the tax system and avoiding an excessive administrative burden for the authorities. The Court, however, recalled that what is at stake is not the system as such or its practical application, but the absolute denial of the tax benefit where the taxpayer is unable to submit a tax deduction form, even if he fulfils all the other conditions for eligibility. It cannot be assumed that a taxpayer is unable to provide relevant documentation on pension income earned in another MS, which the tax authorities may still require from the taxpayer as proof. In any event, practical difficulties cannot justify the infringement of a fundamental freedom and Luxembourg had not established a direct link between the tax credit and pensions from other MS which are taxable in Luxembourg. It followed that the legislation in question was prohibited under both Arts 21 and 45 TFEU.[668]

(c) Frontier Workers: *Gilly* and *Eschenbrenner*

Gilly concerned the calculation of income tax for Mr and Mrs Gilly, who lived in France near the German border. Mr Gilly, a French national, worked at a State school in France, while Mrs Gilly, a French-German national, worked at a State school in Germany. The Franco-German double taxation treaty provided for an exception to the general rule that income is taxable in the country where the work is performed, namely that frontier workers are taxed in their State of residence. In addition, the treaty provides that income from public service is taxable in the paying State, unless the special rule for teachers applies. The public service income received by Mrs Gilly in Germany was taxed in both Germany and France, so she was entitled to a tax credit equal to the French income tax. Due to the greater progression of the tax scale in Germany, this amount was lower than the tax paid in Germany. The applicants therefore claimed unjustified, discriminatory and excessive taxation.[669]

The Court first examined whether the facts of the case fell within the scope of the free movement of workers, which it answered in the affirmative. It then examined the compatibility of the tax connecting factors with (now) Art 45 TFEU, including classification as a frontier

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[668] Case C-300/15 *Kohll and Kohll-Schlesser* [2016] ECLI:EU:C:2016:361, paras 36-62; see also Case C-174/18 *Jacob and Lennertz* [2019] ECLI:EU:C:2019:205, in which the Court ruled that Belgium was depriving a resident couple, one of whom received a pension in another MS, of certain tax advantages; Case C-35/19 *Belgian State (Indemnité pour personnes handicapées)* [2019] ECLI:EU:C:2019:894, in which the Court ruled that a tax exemption for disability allowances on condition that they are paid by an institution of the MS concerned, thereby excluding allowances paid by other MS, is contrary to Art 45 TFEU; see also Case C-60/21 *Commission v Belgium (Déduction des rentes alimentaires)* [2022] ECLI:EU:C:2022:172, in which the Court ruled that Belgium had failed to fulfil its obligations under Art 45 TFEU by refusing to deduct from taxable income maintenance payments to non-resident Belgian pensioners who receive less than 75% of their income in Belgium and who cannot benefit from that deduction in their State of residence.

[669] Case C-336/96 *Gilly* [1998] ECR I-2793, paras 2-13.

worker, classification as a teacher in short-term residence or employment in the private or public sector. It held that in the absence of harmonisation at EU level, such differentiation cannot be considered discriminatory.[670] As regards the consideration of Mrs Gilly's personal and family circumstances with regard to the greater progressivity of the German tax scale compared to the French tax scale, the Court noted that the agreement aims to avoid double taxation, not to ensure that the tax in one State is not higher than that to which the taxpayer would be subject in the other State. This is all the more true since the situation of residents and non-residents is not comparable. In the present case, the income obtained in Germany was aggregated in the context of the basis of assessment for the income tax payable by the taxpayer in France, taking into account her personal circumstances. Thus, the tax credit mechanism provided for in the agreement does not violate Art 45 TFEU.[671]

Mr Eschenbrenner, a French national living near the German border, was employed as a driver by a company based in Germany. According to the Franco-German tax convention, he was considered a frontier worker, who received his salary in Germany but was liable for tax in France. After the opening of insolvency proceedings against his German employer, Mr Eschenbrenner applied for the payment of an insolvency benefit based on the outstanding salary claims. In order to calculate the amount of insolvency benefits based on his salary, the German Federal Employment Agency relied on German tax law. Mr Eschenbrenner complained that taking into account the tax rate applicable in Germany was discriminatory because he was not liable to pay tax in Germany. The referring court sought to ascertain from the ECJ whether Art 45 TFEU precludes the amount of the insolvency benefit granted by a MS to a frontier worker who is not subject to income tax in that State and for whom that benefit is not taxable from being determined by deducting income tax from the remuneration on which the calculation of that benefit is based, with the result that that frontier worker, unlike persons working and resident in that State, does not receive a benefit corresponding to his previous net remuneration.[672]

In order to determine whether the method of calculating the insolvency benefit constitutes unequal treatment, the Court considered it necessary to first examine whether a frontier worker is worse off than a person who works and resides in Germany. Accordingly, persons who work and reside in Germany receive an amount of insolvency benefit corresponding to their previous net remuneration. In contrast, for frontier workers who are not liable to pay tax in Germany, the

[670] Case C-336/96 *Gilly* [1998] ECR I-2793, paras 19-35.
[671] Case C-336/96 *Gilly* [1998] ECR I-2793, paras 40-54.
[672] Case C-496/15 *Eschenbrenner* [2017] ECLI:EU:C:2017:152, paras 14-25.

insolvency allowance is calculated by deducting from the remuneration the tax that would have been deducted if the worker had been subject to tax in Germany. The unfavourable consequence of the German taxability of the benefit results from the differences between the tax rates in the MS. There was consequently no infringement of Art 45 TFEU, since EU law does not exclude such unfavourable consequences solely on the basis of different tax rates in the MS.[673]

4.3.1.2. Interim Conclusion on the Free Movement of Workers

The discriminatory criterion under Art 45 TFEU is basically that of residence, which is comparable to nationality. Nevertheless, the Court has ruled in many instances that, in principle, residents and non-residents are not considered comparable. If, however, neither the State of residence nor the State of employment takes into account the personal and family circumstances of taxpayers, these individuals are denied benefits simply because they work in a State other than their State of residence or nationality. Often, the majority of income is earned in the State of employment, meaning that the State of residence is effectively unable to take personal and family circumstances into account. The result is a restriction on the freedom of movement. An example of this approach by the ECJ is the judgement in the *Wallentin* case, which concerned a Swedish regulation under which a special income tax applied to persons resident abroad who receive income during short stays in Sweden (limited taxpayers). The basic tax-free allowance was only granted to full taxpayers in Sweden. The ECJ initially stated that residents and non-residents are not comparable in principle, unless non-residents do not earn significant income in their country of residence, but only in their country of employment, so that their personal and family circumstances are not taken into account. This represents a restriction (which could not be justified in the present case).[674]

The non-discrimination test for Art 45 TFEU amounts to an analysis of the comparability of the situations of taxpayers, mostly residents and non-residents, and the distinction between them. The question arises as to the actual impact of depriving non-residents of certain rights and benefits to which residents are fully entitled. MS must have regard to the circumstances of a person and cannot simply refuse benefits because this would impose an administrative burden on their authorities. Although personal and family circumstances are to be considered, a (non-resident) taxpayer cannot expect to be entitled to the same tax rates as someone who does not exercise their right to free movement. Equal treatment does not mean exact treatment, but the inclusion and consideration of income from abroad. This is reinforced by the fact that direct

[673] Case C-496/15 *Eschenbrenner* [2017] ECLI:EU:C:2017:152, paras 26-49.
[674] Case C-169/03 *Wallentin* [2004] ECR I-6443.

taxes are not harmonised and countries can therefore opt for different tax rates. The resulting unfavourable consequences cannot be regarded as discrimination.

With regard to the case law on the free movement of workers, the Court has carried out a very consistent review over the years. The comparability of the situations of taxpayers remains the basis for the examination and is performed right after having established the applicability of Art 45 TFEU. There were only a few exceptions where this was not the case and where the analysis was carried out at the level of justification (see e.g. *Kohll and Kohll-Schlesser*).

4.3.2. Arts 49 and 54 TFEU – Freedom of Establishment

The freedom of establishment is by far the most important fundamental freedom in the area of direct taxation, measured by the number of ECJ judgements. The freedom of establishment prohibits all national measures that prevent or restrict EU citizens and companies from moving to another MS to take up an economic activity on a stable and continuous basis there.[675] Arts 49 and 54 TFEU apply only to persons and companies (including agencies, branches and subsidiaries) in a MS other than that of their nationality or seat. Discrimination occurs when the natural or legal person exercising the right of establishment is not treated in the same way as a national. The freedom of establishment prohibits not only unequal treatment, but any unjustified obstacle.[676] This prohibition applies both to the home and host State.[677] Since Art 49 TFEU is to be interpreted broadly, the activities that fall within its scope have also been interpreted broadly so that all activities of a commercial and economic nature are covered.[678] The freedom of establishment can be distinguished from the freedom to provide services, i.e. the temporary exercise of activities, by the requirement of a permanent place from which the natural or legal person of a MS exercises their trade or profession in another MS. The distinction is essentially based on the degree of the establishment or the duration and focus of the activity.[679]

The freedom of choice for the appropriate legal form in which to pursue activities in a different MS must not be limited by discriminatory tax provisions. Until today, there has been extensive case law on the compatibility with EU law of tax rules that distinguish between resident and non-resident persons, companies and subsidiaries, especially in connection with the holding of

[675] Jonathan Tomkin, 'Article 49 TFEU' in Manuel Kellerbauer, Marcus Klamert and Jonathan Tomkin (eds), *The EU Treaties and the Charter of Fundamental Rights: A Commentary* (OUP 2019) 649ff.
[676] Paul Craig and Gráinne de Búrca, *EU Law: Text, Cases, and Materials* (7th edn, OUP 2020) 839.
[677] Case C-657/13 *Verder LabTec* [2015] ECLI:EU:C:2015:331, para 33.
[678] Case C-384/08 *Attanasio Group* [2010] ECR I-2055, para 35; Case C-281/06 *Jundt* [2007] ECR I-12231, para 32.
[679] Florian Haase, *Internationales und Europäisches Steuerrecht* (7th edn, C F Müller 2023) para 843.

participations and the taxation of dividends. The ECJ repeatedly held that the corporate seat or registered office is the connecting factor with a national legal system, as is nationality for natural persons.[680] Taxing branches or agencies in a MS on the same basis as companies with their registered office in that MS, but not giving them the same tax advantages infringes the freedom of establishment.

As with the other freedoms, the freedom of establishment is not absolute. Directly discriminatory measures can be justified on grounds provided for by the Treaty, while restrictive measures can be justified by overriding reasons in the general interest (e.g. effectiveness of fiscal supervision) if they are equally proportionate.[681] The Court previously held that purely economic considerations cannot constitute such overriding reasons (e.g. risk of tax avoidance).[682] The Court accepted that in certain cases, a distinction based on the location of the seat of a company or the residence of a person may be justified.[683] The differences between the tax systems make it clear that the use of the freedom of establishment is not always advantageous for the individuals or companies concerned. This is also illustrated by the selected cases below.

4.3.2.1. ECJ Case Law on the Freedom of Establishment

This chapter reviews key judgments of the ECJ on the freedom of establishment, with a focus on tax measures that affect cross-border economic activity and the treatment of companies and individuals that make use of this freedom. The selection of cases is divided into several main categories: the early landmark *Avoir Fiscal* case laid the foundation for the Court's interpretation of the freedom of establishment in the context of direct taxation; cases on loss deduction and carry-forward rules are essential to understanding the cross-border treatment of financial obligations and business losses; immediate taxation of capital gains upon emigration and taxation of group companies address the implications of cross-border transactions and relocations; cases involving the ability to be treated as a resident and withholding taxes demonstrate the complexities of applying tax rules to companies and individuals; the granting of tax advantages related to personal and family circumstances and the deductibility of pension contributions illustrate how the Court addresses the interplay between personal factors and the

[680] C-270/83 *Commission v France* [1986] ECR 273, para 18; Case C-68/15 *X* [2017] ECLI:EU:C:2017:379, para 35.
[681] Case C-19/92 *Kraus* [1993] ECR I-1663, para 32; C-250/95 *Futura Participations and Singer* [1997] ECR I-2471, para 31.
[682] Case C-96/08 *CIBA* [2010] ECR I-2911, para 48; Case C-270/83 *Commission v France* [1986] ECR 273, para 25.
[683] See eg Case C-337/08 *X Holding* [2010] ECR I-1215.

broader tax framework, ensuring consistent treatment in cross-border contexts; finally, progressive taxation sheds light on how the Court assesses tax structures that at first glance appear unremarkable in terms of equal treatment. These categories represent recurring themes in ECJ case law on the freedom of establishment, as can be seen from the further cases cited in the footnotes, which once again underlines their continued relevance in EU tax law. In addition, both older and more recent decisions are analysed so that any development in the ECJ's methodology can be better identified.

(a) The Beginnings: *Avoir Fiscal*

The first case, which strictly applied the discrimination analysis to a tax case was *Avoir Fiscal* in 1986. The French tax legislation at issue provided for a shareholders' tax credit (*avoir fiscal*) benefitting those insurance companies whose registered office was in France including subsidiaries by foreign insurance companies set up in France. However, that benefit was not granted to branches or agencies in France by companies whose registered office was in another MS. Thus, insurance companies having their registered office in another MS but pursuing their activities in France through branches or agencies were treated differently than insurance companies having their registered office in France. The Commission regarded this law as discriminatory and as an indirect restriction on the freedom of (secondary) establishment.[684] The Court sided with the Commission and held, contrary to what the French government brought forward, that the difference in treatment cannot be justified or balanced out by other advantages enjoyed by those companies with their registered office abroad as those advantages cannot justify a breach of the freedom of establishment, which prohibits all discrimination even if only of a limited nature.[685]

(b) Deductibility of Pension Contributions: *Wielockx* and *Montag*

Wielockx also concerned the interpretation of (now) Art 49 TFEU. The Dutch law in question introduced a voluntary tax regime on pension provisions for self-employed persons, according to which they could use part of their business profits to build up pension provisions, with the amount set aside per year remaining in the business. Accordingly, national (resident) taxpayers were subject to income tax on their business profits reduced by the amounts added to the pension reserve and increased by the amounts withdrawn from it. Foreign (non-resident) taxpayers, on the other hand, were only taxed on their income in the Netherlands, which did not

[684] Case C-270/83 *Commission v France* [1986] ECR 273, paras 1-7.

[685] Case C-270/83 *Commission v France* [1986] ECR 273, paras 11ff; similarly Case C-311/97 *Royal Bank of Scotland* [1999] ECR I-2651, where a difference in treatment was introduced in the calculation of the tax on the profits of companies depending on whether they are based in Greece or abroad.

include deductible contributions to the pension reserve.[686] Mr Wielockx, a Belgian national and resident, was a partner in a physiotherapy practice in the Netherlands and was refused by the Dutch authorities from deducting contributions to a pension provision from his taxable income. As the Dutch court had doubts about the compatibility of the law on pension provisions with the freedom of establishment, it stayed the proceedings and asked the ECJ for a preliminary ruling on the issue.[687]

The Court ruled that non-resident taxpayers who receive all or most of their income in the State of employment are objectively in the same situation with respect to income tax as residents of that State who perform the same work there. Both are taxed only there and their taxable income is the same. One difference, however, is that the personal situation of the non-resident taxpayer is not taken into account in either the State of residence or the State of employment. Thus, non-resident taxpayers are discriminated against. As a justification, the Dutch Government tried to invoke the principal of fiscal cohesion. However, the Court held that this principle is guaranteed by a bilateral agreement concluded between MS and therefore cannot be used to justify the denial of a deduction such as the one at issue. The Court concluded that a rule which allows residents to deduct from their taxable income business profits which they use to build up a pension provision, but denies that benefit to taxable non-residents, who although resident in another MS, receive all or most of their income in the first State, cannot be justified on the ground that the regular pension payments, which the non-resident taxpayer subsequently withdraws from the pension reserve are taxed not in the first State but in the State of residence with which the first State has concluded a double taxation convention. Such discrimination is therefore contrary to Art 49 TFEU.[688]

In a similar more recent case, the Court reversed the order of its assessment and first examined the existence of a restriction before establishing the comparability of the situations and finally examining possible justifications. *Montag* also dealt with the refusal to deduct contributions to an occupational pension scheme and to a private pension scheme as special expenses. Mr Montag, a German national, was resident in Belgium where he worked as a lawyer in a law firm registered as a limited liability partnership in which he held shares. The income earned was treated as income from several countries. In order to work as European lawyer in Belgium under the German professional title of *Rechtsanwalt*, he had to be registered with the Cologne Bar

[686] Case C-80/94 *Wielockx* [1995] ECR I-2493, paras 1-7.
[687] Case C-80/94 *Wielockx* [1995] ECR I-2493, paras 10-12.
[688] Case C-80/94 *Wielockx* [1995] ECR I-2493, paras 20-27; similarly Case C-251/98 *Baars* [2000] ECR I-2787, making a wealth tax allowance dependent on the seat of the company; differently Case C-112/91 *Werner* [1993] ECR I-429, where the Court held that resident and non-resident taxpayers are not in a comparable situation.

Association and the North Rhine-Westphalia Lawyer's Pension Scheme. As Mr Montag was subject to unlimited income tax liability in Belgium, his compulsory contributions to the Belgian statutory social security system were deducted, but not his pension expenses in Germany. According to the German tax authorities, the contributions could not be deducted because they were considered special expenses which were not deductible in the case of limited tax liability. Since the German Federal Constitutional Court had previously ruled that the treatment of provident expenses as special expenses was not unconstitutional, the applicant applied for the deduction of his pension expenses as special expenses. The Cologne Finance Court found that although Mr Montag earned most of his income in Germany, he earned sufficient income in Belgium to allow his personal circumstances to be taken into account there. It decided to stay the proceedings and refer the question whether pension expenses should be treated as expenses related to personal and family circumstances or as expenses related to income earned in Germany. Hence, the referring court wished to know whether legislation which prevents a non-resident taxpayer with limited tax liability from deducting compulsory and additional contributions to an occupational or private pension scheme infringes Art 49 TFEU, whereas resident taxpayers with unlimited tax liability may deduct such contributions from their income tax.[689]

The Court first examined whether there was a restriction of Art 49 TFEU. In this regard, it held that allowing the deduction of contributions to pension schemes as special expenses from the income of resident taxpayers but not from non-resident taxpayers with limited tax liability constitutes a restriction, as the tax treatment of non-resident taxpayers is less advantageous because they cannot benefit from this tax advantage.[690]

It then examined the comparability of the situations of resident and non-resident taxpayers. The Court noted that a resident and a non-resident are in a comparable situation only if the pension expenses can be treated as expenses directly linked to an activity giving rise to taxable income in Germany. As far as the compulsory contributions to the lawyer's provident institution are concerned, the applicant was obliged to pay them due to his admission to the bar. Hence, these expenses must be regarded as necessary for membership of the bar association, which in turn is necessary in order to be able to carry out the activity of a lawyer in Germany and Belgium that gave rise to the taxable income. These contributions are therefore directly linked to the activity that has led to the taxable income in Germany (and Belgium). It follows that the situation of a

[689] Case C-480/17 *Montag* [2018] ECLI:EU:C:2018:987, paras 1-20.
[690] Case C-480/17 *Montag* [2018] ECLI:EU:C:2018:987, paras 21-26.

non-resident taxpayer is comparable to that of a resident taxpayer as far as the share of the contributions paid is concerned, which corresponds to the share that the taxable income in Germany has in the total income earned. The additional contributions, which are based on a free decision to increase the pension entitlement, cannot be regarded as necessary for practicing the profession of lawyer in Germany. Therefore, non-resident taxpayers are not in a comparable situation to resident taxpayers. As regards the contributions to a private pension scheme, there is no direct link between these expenses and the exercise of the legal profession from which the income derives. These situations are not comparable either.[691]

In a final step, the Court examined the grounds for justification. In that context, it held that the defendant had not enabled the Court to assess the scope of the argument concerning the risk that the contributions would also be deducted in other MS where it has not been argued that that risk could not have been avoided by the mutual assistance of competent authorities. Consequently, Art 49 TFEU precludes a rule under which a non-resident taxpayer cannot deduct compulsory contributions paid to an occupational pension scheme if they are directly linked to the activity from which the income is derived, whereas resident taxpayers are entitled to do so. However, Art 49 TFEU does not preclude legislation under which non-resident taxpayers cannot deduct additional contributions paid into an occupational or private pension scheme, whereas resident taxpayers are allowed to do so.[692]

(c) Loss Carry-Forward: *Futura Participations and Singer*

The proceedings of *Futura Participations and Singer* concerned Futura, a French resident company, Singer, its Luxembourg branch, and the Luxembourg tax authorities in connection with the determination of Singer's tax liability. The tax authorities refused to allow the claimants to carry forward losses because, according to Luxembourg law, non-resident taxpayers can only do so if the losses are economically linked to income earned locally and if accounts are kept within that country. This decision was based on Singer's lack of proper accounting. The applicants claimed that this rule and decision affected their freedom of establishment.[693]

The Court examined the two conditions provided for in Luxembourg law, namely the requirement of an existing economic link and the requirement of keeping accounts. As regards the first condition, the Court found that it was consistent with the principle of territoriality and

[691] Case C-480/17 *Montag* [2018] ECLI:EU:C:2018:987, paras 27-58.
[692] Case C-480/17 *Montag* [2018] ECLI:EU:C:2018:987, paras 59-62.
[693] Case C-250/95 *Futura Participations and Singer* [1997] ECR I-2471, paras 2-13.

could therefore not be regarded as a discriminatory measure. As regards the second condition, it found that it particularly affects companies established in another MS, as they have to keep accounts in more than one State, which treats companies wishing to establish a branch in their MS differently from resident companies, which is in principle prohibited by Art 49 TFEU.[694]

It continued with the justification analysis. According to the Luxembourg government, proper accounting is a requirement of proof justified by the need to ensure that the losses that can be carried forward actually arise from Luxembourg activities and that the amount of the losses corresponds to the amount actually incurred by the taxpayer. However, the Commission argued that, although the aim pursued was legitimate, the condition for achieving it was not indispensable, since it was possible to obtain information from other MS via the system provided for by the Directive on mutual assistance in the field of direct taxation. The Court considered that the effectiveness of fiscal supervision constitutes an overriding requirement of general interest capable of justifying a restriction and that the aims of the second condition would not be attained if the authorities had to have recourse to the accounts of non-resident taxpayers in another MS.[695] With regard to the proportionality of the second condition, it noted that non-resident taxpayers are generally not obliged to keep proper accounts of their Luxembourg activities. This is only the case if a non-resident taxpayer wants to carry forward losses from previous years. Since the purpose of this condition is to clearly and precisely determine the amount of losses to be carried forward, the authorities cannot refuse to do so on the grounds that there is no proper accounting. Hence, such a condition is not in line with Art 49 TFEU. MS may only require non-resident taxpayers to demonstrate clearly and precisely that the amount of losses claimed corresponds to the amount of losses actually incurred in that State.[696]

(d) Emigration and Immediate Taxation of Capital Gains: *de Lasteyrie du Saillant* and *A*

De Lasteyrie du Saillant concerned the taxation of an unrealised increase in the value of securities due on a transfer of residence outside France. According to French law, taxpayers who intend to transfer their tax residence abroad are to be subject to immediate taxation on capital gains not yet realised (deferred capital gains), which would not be taxed if these taxpayers were resident in France. The taxpayers concerned may request a suspension of tax payment, provided that they set up guarantees to ensure recovery of the tax. When Mr Lasteyrie

[694] Case C-250/95 *Futura Participations and Singer* [1997] ECR I-2471, paras 18-26.
[695] Case C-250/95 *Futura Participations and Singer* [1997] ECR I-2471, paras 26-35.
[696] Case C-250/95 *Futura Participations and Singer* [1997] ECR I-2471, paras 36-43; similarly Case C-264/96 *Imperial Chemical Industries v Colmer* [1998] ECR I-4695; similarly Case C-446/03 *Marks & Spencer* [2005] ECR I-10837.

left France to settle in Belgium, he held securities entitling him to 25% of the profits of a company established in France. The value of these insecurities increased over the years compared to the acquisition price and this increase in value was taxed.[697]

The Court first examined whether the legislation in question was capable of restricting the freedom of establishment. It concluded that, although the law does not in principle prevent a French taxpayer from exercising his right of establishment, it nevertheless restricts that right and thus has a deterrent effect on persons wishing to establish themselves in another MS. This puts them at a disadvantage compared to persons who maintain their residence in France. There is therefore unequal treatment, since the taxpayer becomes liable to tax on the unrealised income as a result of the transfer of establishment, whereas the increase in value if it remained in France would only become taxable after its realisation. With regard to the suspension of tax payments, the Court noted that such suspension is not automatic and is subject to strict conditions that cannot override the restrictive effect of the rules.[698]

It then considered possible justifications, in particular the justification aimed at preventing tax avoidance. The Court rejected this justification on the grounds that French legislation is aimed at any situation in which a taxpayer holding a substantial interest in a company transfers its tax residence abroad, and is not specifically aimed at excluding purely artificial arrangements to circumvent French law from any tax benefit. The mere transfer of tax residence outside the territory of a MS cannot be considered as tax avoidance. Moreover, the objective of avoiding tax transfers to avoid paying tax on the appreciation due in France can also be achieved by less restrictive means, e.g. by taxing the appreciation upon return to France after a short stay in another MS. Finally, the Court reiterated that the sole fact of transferring tax residence to another MS with a different tax system that might be more advantageous for the taxpayer cannot justify a restriction on the freedom of establishment.[699]

In *de Lasteyrie du Saillant*, the Court examined the infringement of Art 49 TFEU on the basis of a two-step assessment, namely first the existence of a restriction or obstacle and second the existence of possible justifications. In neither step did it resort to the requirement of

[697] Case C-9/02 *de Lasteyrie du Saillaint* [2004] ECR I-2409, paras 1-18.
[698] Case C-9/02 *de Lasteyrie du Saillaint* [2004] ECR I-2409, paras 39-49.
[699] Case C-9/02 *de Lasteyrie du Saillaint* [2004] ECR I-2409, paras 50-60; similarly Case C-14/16 *Euro Park Service* [2017] ECLI:EU:C:2017:177, which concerns the granting of a deferral of taxation of capital gains in the case of a cross-border merger; similarly Joined Cases C-327/16 and C-421/16 *Jacob* [2018] ECLI:EU:C:2018:210, which concerns the taxation of capital gains from an exchange of securities with subsequent transfer of the securities received.

comparability of situations to establish or justify (un)equal treatment. In a similar more recent case, this was done, but only after a restriction had been established.

The case *A* concerned the immediate taxation of capital gains of a non-resident permanent establishment of a resident company arising from the transfer of that permanent establishment to another non-resident company. A, a company incorporated under Finnish law, transferred a permanent establishment in Austria to an Austrian company and received shares in return. A was taxed on the capital gains resulting from this transaction. A complained that the Finnish legislation in question impeded the freedom of establishment because in an equivalent national situation taxation would only take place when the capital gains were realised. The referring court therefore sought to know whether Art 49 TFEU precludes legislation which provides for immediate taxation of capital gains arising from a transfer where a resident company transfers a non-resident permanent establishment to a non-resident company and which does not allow deferral, whereas in a national situation such capital gains are taxed only on the disposal of the assets transferred.[700]

The Court merely held that such a situation constituted an impediment to the freedom of establishment, since such difference in treatment discourages companies established in Finland from carrying on an economic activity in another MS through a permanent establishment. Accordingly, such an impediment is permissible only if it relates to situations which are not objectively comparable or if it can be justified by overriding reasons in the public interest. As regards the comparability of situations, the Court ruled that the situation of a company transferring a non-resident permanent establishment generating capital gains in that MS to a non-resident company is comparable to the situation of a resident company transferring a permanent establishment to another resident company. As regards justification, the Court stated that a MS is entitled to tax capital gains realised in its tax territory before the transfer at the time of the transfer. The transfer of a non-resident permanent establishment of a resident company to a non-resident company cannot mean that the MS concerned has to waive its right to tax the capital gains realised in its tax territory before the transfer. Such a rule is therefore appropriate to ensure the allocation of taxing powers. Finally, the Court examined the proportionality of the rule. First, it noted that it is indeed proportionate to set the amount of tax on the capital gains realised in its tax territory at the time when the taxing jurisdiction ends, namely at the time of the transfer. Secondly, it pointed out that it is less harmful to allow the taxpayer to choose between immediate payment of the tax and tax deferral than to levy the tax immediately. The

[700] Case C-292/16 *A* [2017] ECLI:EU:C:2017:888, paras 1-15.

legislation at issue therefore goes beyond what is necessary to achieve the objective of preserving the allocation of taxing powers and infringes Art 49 TFEU.[701]

(e) Withholding Tax: *Denkavit* and *Deister*

The methodological difference in the assessment of discrimination between the free movement of workers and the freedom of establishment can especially be observed in cases involving the (non-)exemption of withholding taxes on dividend payments between resident and non-resident taxpayers. Such a method of assessment has already been applied in the context of the examination of Art 63 TFEU, as will be shown below. An example for the freedom of establishment is the *Denkavit* case, which dealt with the imposition of a withholding tax on the payment of dividends by a resident subsidiary (Denkavit France and Agro Finances in France) to a non-resident parent company (Denkavit Internationaal in the Netherlands), while dividends paid by a resident subsidiary to a resident parent company were fully exempt from corporation tax.[702] The referring court essentially asked whether such national legislation is compatible with the freedom of establishment.[703]

The Court first pointed out the difference in treatment of dividends paid by resident subsidiaries to non-resident or resident parent companies. Resident parent companies are fully exempt from dividend tax, whereas non-resident parent companies are subject to a withholding tax of 25%. Such a different treatment constitutes a restriction of Arts 49 and 54 TFEU.[704] The Court then noted the comparability of the situations between resident and non-resident parent companies receiving dividends paid by resident subsidiaries. The tax relief for French residents must thus be extended to non-residents to the extent that such a burden on non-residents arises from France's exercise of tax sovereignty over them. By refusing to do so, France imposes a heavier burden on dividends paid by a French subsidiary to a Dutch parent company than on dividends paid to a French parent company, which is discriminatory. Since the French government did not provide any justification, the Court found unjustified discrimination.[705] The Court further clarified that the Franco-Dutch double taxation convention or Dutch law cannot overcome the

[701] Case C-292/16 *A* [2017] ECLI:EU:C:2017:888, paras 16-40, similarly Case C-646/15 *Trustees of the P Panayi Accumulation & Maintenance Settlements* [2017] ECLI:EU:C:2017:682, which concerns the taxation of unrealised capital gains on the assets of a trust when its trustees transfer their residence to another MS; see also Case C-707/20 *Gallaher* [2023] ECLI:EU:C:2023:101, which concerns the deferral of tax payment on two transactions involving the disposal of assets by a UK company to companies that are not tax resident in the UK and are part of the same group.

[702] Case C-170/05 *Denkavit Internationaal and Denkavit France* [2006] ECR I-11949, paras 1-16.

[703] Case C-170/05 *Denkavit Internationaal and Denkavit France* [2006] ECR I-11949, para 18.

[704] Case C-170/05 *Denkavit Internationaal and Denkavit France* [2006] ECR I-11949, paras 26-29.

[705] Case C-170/05 *Denkavit Internationaal and Denkavit France* [2006] ECR I-11949, paras 36-41.

restrictive effects of the French law in question and cannot be invoked to avoid Treaty obligations.[706]

The *Deister* case concerned the refusal of the German authorities to exempt from withholding tax dividends received by the German subsidiaries of Deister Holding and Juhle Holding, registered in the Netherlands and Denmark respectively. Under German law, dividends distributed by a resident subsidiary to a non-resident parent company are either exempt at the request of the taxpayer or subject to withholding tax, which may be refunded at the request of the taxpayer. However, the right to exemption is precluded if, first, the shareholders of the non-resident parent company would not have been entitled to the exemption or refund if they had received the dividends directly, and second, one of the following three conditions is met (i) there are no economic or other substantial reasons for the involvement of the non-resident parent company, (ii) the non-resident parent company does not derive more than 10% of its total gross income from its own activities, or (iii) the non-resident company does not engage in general economic commerce through a business establishment suitably equipped for its business purpose. However, in the case of a resident parent holding company, the existence of a permanent involvement is sufficient to grant a credit or refund of the tax. The referring court therefore referred to the ECJ the question whether a rule is contrary to Art 49 TFEU which denies persons who hold shares in a non-resident parent company and who would not be entitled to a refund of or exemption from withholding tax if they received the dividends directly from a resident subsidiary the exemption from income tax arising from capital duty on profit distributions to that parent company, provided that one of the conditions laid down in that rule is met.[707]

The Court first considered the freedom applicable to the case at hand and held that tax treatment of dividends may fall within the scope of both the freedom of establishment and the free movement of capital. On the one hand, national law intended to apply only to shareholdings which enable the holder to exercise a definite influence over the decisions of a company and to

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[706] Case C-170/05 *Denkavit Internationaal and Denkavit France* [2006] ECR I-11949, paras 42-53; similarly Case C-307/97 *Saint-Gobain ZN* [1999] ECR I-6161, on the denial of tax benefits for the taxation of dividends to German-resident permanent establishments of non-resident companies; see also Case C-374/04 *Test Claimants in Class IV of the ACT Group Litigation* [2006] ECR I-11673, in which the UK introduced a difference in treatment between resident companies and resident shareholders who received a tax credit for dividends from other resident companies, but did not extend that tax credit to non-resident companies or shareholders who received dividends from resident companies, except in cases covered by DTCs – the Court did not consider those situations to be comparable; Case C-446/04 *Test Claimants in the FII Group Litigation* [2006] ECR I-11753, in which the Court ruled that a for avoiding double taxation of dividends paid by resident companies to residents must be extended to dividends paid by non-resident companies to residents.

[707] Case C-504/16 *Deister Holding* [2017] ECLI:EU:C:2017:1009, paras 1-34.

determine its activities falls within the scope of Art 49 TFEU. On the other hand, national law applicable to shareholdings acquired only with the intention of making a financial investment without exercising any influence over the management and control of the undertaking is to be examined under Art 63 TFEU. In the present case, the applicants held a larger part or all of the share capital, which allowed for a definite influence on decisions and therefore fell under the freedom of establishment.[708]

Next, the Court found a difference in treatment and an impediment to the freedom of establishment where the granting of an exemption from withholding tax on the distribution of profits by a resident subsidiary to a non-resident parent company is made subject to the conditions laid down in the legislation concerned. As regards comparability, the Court has previously held that the situation of non-resident shareholders is comparable to that of resident shareholders, since a MS exercises its power to tax not only over the income of resident shareholders but also over that of non-resident shareholders from dividends received from a resident company. Applied to the present case, it concluded that the non-resident parent company is in a comparable situation to a resident parent company. As regards justification by the objective of combating tax evasion and avoidance and maintaining a balanced allocation of taxing powers, the Court noted that the legislation at issue is not specifically designed to exclude only wholly artificial arrangements aimed at obtaining the advantage. The mere fact that such persons have such holdings is in itself an indication of the existence of a wholly artificial arrangement. As far as the allocation is concerned, the Court merely referred to the Parent-Subsidiary Directive and thus rejected the justifications.[709]

(f) Taxation of Group Companies: *Thin Cap Group Litigation*, *Hornbach-Baumarkt* and *Contship Italia*

Thin Cap Group Litigation, a case of a group litigation, concerned thin capitalisation rules, i.e. the tax treatment of interest paid by UK resident companies on loans granted by a company belonging to the same group but not resident in that (former) MS. All cases involved a UK resident company that was at least 75% owned by a non-resident parent company and received a loan from that parent company and another non-resident company owned by the parent company. The plaintiff companies complained of tax disadvantages due to additional

[708] Case C-504/16 *Deister Holding* [2017] ECLI:EU:C:2017:1009, paras 76-85.

[709] Case C-504/16 *Deister Holding* [2017] ECLI:EU:C:2017:1009, paras 86-100, similarly Case C-6/16 *Eqiom and Enka* [2017] ECLI:EU:C:2017:641, in which the Court ruled that it is contrary to Art 49 TFEU to make exemption from withholding tax on profits distributed by a resident subsidiary to a non-resident parent company, where that parent company is directly or indirectly controlled by one or more persons resident in third countries, conditional on that parent company proving that the main purpose of the interlocking interests is not to benefit from that exemption.

corporation tax resulting from the refusal to deduct interest paid on loan finance from taxable profits and additional tax resulting from the conversion of loans into equity. The referring court asked whether the UK legislation was compatible with the freedom of establishment, the freedom to provide services and the free movement of capital.[710]

The Court held that legislation such as the one at hand is aimed at relations within groups of companies and thus primarily affects the freedom of establishment, the restriction of which has inevitable effects on the other two freedoms as well, which therefore do not need to be examined independently.[711] According to the Court, the present thin capitalisation rules, which treat interest paid by one company to another company in the same group as a distribution, result in a difference in treatment between resident borrowers depending on whether the lending company is resident in the UK or not.[712] The Court further specified that such a different treatment is liable to restrict Art 49 TFEU, even though the Court acknowledged that multinational group companies cannot be directly compared with group companies established in the same MS. This is because exercising the right to free movement becomes less attractive for companies in other MS, as they might refrain from acquiring, establishing or maintaining subsidiaries in such a MS.[713] The Court continued to consider the justifications put forward, namely the need to ensure the cohesion of the tax system and to prevent tax avoidance. The Court rejected the first argument and held that the fact that a resident company receives a loan from a related company in another MS cannot be considered an abusive practice that would justify a restriction on the freedom of establishment. It acknowledged that treating the interest as a distribution is suitable for preventing practices that serve solely to avoid tax. However, such legislation must be proportionate, which can be verified by examining whether the loan was granted at arm's length. Hence, the Court concluded that Art 49 TFEU precludes legislation which restricts the ability of a resident company to deduct interest on a loan granted by a non-resident parent company, unless that legislation provides for objective and verifiable elements which make it possible to establish the existence of purely artificial arrangements and which allow taxpayers to prove that a transaction is economically justified. Such legislation may treat interest as a distribution of such an arrangement only to the extent that it exceeds what would have been agreed at arm's length.[714]

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[710] Case C-524/04 *Test Claimants in the Thin Cap Group Litigation* [2007] ECR I-2107, paras 1-22.
[711] Case C-524/04 *Test Claimants in the Thin Cap Group Litigation* [2007] ECR I-2107, paras 26-35.
[712] Case C-524/04 *Test Claimants in the Thin Cap Group Litigation* [2007] ECR I-2107, paras 38ff.
[713] Case C-524/04 *Test Claimants in the Thin Cap Group Litigation* [2007] ECR I-2107, paras 59-61.
[714] Case C-524/04 *Test Claimants in the Thin Cap Group Litigation* [2007] ECR I-2107, paras 64-92; cf Case C-439/97 *Sandoz* [1999] ECR I-7041, which examined the levy on the value of loans taken out by resident borrowers from non-resident lenders under the free movement of capital; Joined Cases C-407/22 and C-408/22 *Manitou BF*

Hornbach-Baumarkt concerned proceedings between Hornbach-Baumarkt AG, based in Germany, which operates do-it-yourself stores in Germany and other MS, and the Landau tax office. Hornbach-Baumarkt AG had indirect shareholdings in companies in the Netherlands which had negative equity capital and needed bank loans to continue their business activities. The bank made the loans for these companies dependent on the issuance of comfort letters containing a guarantee declaration by Hornbach, which it issued gratuitously. Since the tax office assumed that unrelated third parties would agree on a consideration under the same circumstances, it adjusted the amount of Hornbach's taxable income. Although Hornbach argued that there was unequal treatment between domestic and foreign transactions in the adjustment of income and that participations in foreign companies were treated less favourably than in resident companies, the referring court agreed with the tax office that the terms agreed between Hornbach and the foreign group companies differed from those that would have been agreed at arm's length. The referring court was however uncertain as to whether commercial justification could be presented as evidence to justify the non-arm's length transaction due to the relationship of dependence between the parties.[715]

In this context, the Court held that the income of a resident taxpayer is only adjusted under German law if the other party to the transaction is resident outside Germany. If, on the other hand, this party is a German resident subsidiary of the taxpayer, the income is not adjusted. Contrary to AG Bobek's opinion that there was no restriction,[716] the Court found that a parent company resident in one MS that holds an interest in a company in another MS is treated less favourably than if it had an interest in a resident company, thus constituting a restriction of Art 49 TFEU. Instead of conducting a comparability analysis, the Court went straight to the justification stage. With regard to Germany's argument that the balanced allocation of taxing powers must be preserved, the Court acknowledged that allowing companies resident in one MS to transfer their profits in the form of advantages to companies in other MS with which they have a relationship of dependence on terms that are not market terms may undermine that balanced allocation. Hence, the German rule is appropriate to ensure this aim. Finally, as regards proportionality, there may be commercial reasons for providing capital on non-market terms if there is insufficient capital available for the expansion of a subsidiary's business. It is

[2023] ECLI:EU:C:2023:392, on the reimbursement of part of the corporate income tax levied on the costs and expenses added back to the profits of companies and incurred in connection with dividends received from their subsidiaries resident in another MS; Case C-585/22 *Staatssecretaris van Financien (Intérêts relatifs à un emprunt intragroupe)* [2024] ECLI:EU:C:2024:822, in which the ECJ upholds the Dutch tax law on the deduction of cross-border interest on loans.

[715] Case C-382/16 *Hornbach-Baumarkt* [2018] ECLI:EU:C:2018:366, paras 4-26.

[716] Case C-382/16 *Hornbach-Baumarkt* [2017] ECLI:EU:C:2017:974, Opinion of AG Bobek.

for the referring court to assess whether Hornbach was able to provide evidence of possible commercial justifications. As a result, the law in question does not go beyond what is necessary to achieve its objective if the authorities allow the taxpayer to prove that the conditions were agreed for commercial reasons.[717]

Another case on group companies that failed the restriction test this time, *Contship*, concerned the application of measures to prevent tax avoidance by shell companies. Contship Italia acquired Borgo Supermercati, a limited liability company under Italian law, which was wholly owned by Eurokai, a company listed on the German stock exchange. The Italian tax authorities considered that Borgo Supermercati fulfilled the criteria of a shell company. At the time of the proceedings, the scope of the legislation providing for the exclusion of anti-avoidance measures was limited to companies listed directly on the Italian regulated market and to trading companies for profit determined on the basis of an operational test to determine productivity. Hence, the referring court inquired into the compatibility with Art 18 TFEU of legislation which excludes from the measures to prevent tax avoidance by non-operational companies only those companies whose securities are traded on Italian regulated markets and not those companies whose securities are traded on a foreign regulated market and the companies which control or are controlled by those listed companies.[718]

As a preliminary point, the Court clarified that the situation in question of an Italian company controlled by a foreign company must instead be assessed under Art 49 TFEU, since Art 18 TFEU only applies when no other freedom is at stake. The Court found that the exclusion of anti-avoidance measures, which apply only to companies whose securities are traded on an Italian regulated market, does not lead to a difference in treatment between a company held by a parent company in Germany and a company held by an Italian parent company. Since, according to the law, only companies listed on the Italian market can benefit from the exemption, it is irrelevant whether the parent company of that company is listed in Italy or abroad. In this context, the Court noted that Contship had never issued securities on the Italian regulated market and therefore could not benefit from the exemption. This would not have changed if the company had been controlled by an Italian company. Accordingly, the Court considered that no advantage is granted to companies held by parent companies listed on the national regulated market and therefore there can be no restriction of Art 49 TFEU.[719]

717 Case C-382/16 *Hornbach-Baumarkt* [2018] ECLI:EU:C:2018:366, paras 27-59.
718 Joined Cases C-433/21 and C-434/21 *Contship Italia* [2022] ECLI:EU:C:2022:760, paras 1-20.
719 Joined Cases C-433/21 and C-434/21 *Contship Italia* [2022] ECLI:EU:C:2022:760, paras 29-48.

(g) Option to be Treated as a Resident: *Gielen*

Mr Gielen, a German resident, operated a glasshouse horticulture business in Germany and set up a permanent establishment in the Netherlands. Under Dutch law, a resident business operator may take into account both hours worked in another MS and hours worked in the Netherlands when calculating the hours test giving entitlement to the self-employed deduction, whereas non-resident business operators may only include hours worked in the Netherlands in that calculation. The hours test corresponds to the performance of at least 1,225 hours of work during the year for one or more undertakings from which the taxpayer makes profit as a business operator. According to the tax authorities, Mr Gielen did not satisfy this hours test. He appealed against this decision, arguing that the denial of entitlement to a self-employment deduction as a non-resident taxpayer constituted discrimination. The Hoge Raad pointed out that the discrimination arose from the fact that, in the case of non-resident taxpayers, not all the hours worked by them for their businesses were taken into account, including those worked for an undertaking in another MS. The referring court was therefore unsure whether such discrimination could be avoided by the option of being treated as a resident, which implies a progressive tax rate.[720]

As regards the discriminatory effects of the legislation, the Dutch government and the Hoge Raad recognised that there was a discrimination on the basis of residence. The ECJ started its examination by assessing comparability and found that in as far as the deduction is granted to all taxpayers satisfying the test, it is not relevant to distinguish whether business operators carry out their work in the Netherlands or in another MS. Consequently, the situation of non-resident taxpayers is comparable to that of resident taxpayers. It then concluded that the application of an hours test which prevents non-resident taxpayers from including the hours worked in another MS could primarily work to the detriment of those taxpayers. Such legislation thus constitutes indirect discrimination on grounds of nationality. The Court also considered whether the option to be treated as a resident could eliminate the discrimination and held that such a choice was not capable of doing so. This would have the effect of confirming a tax regime that in itself continues to violate Art 49 TFEU. Such an option cannot neutralise discrimination.[721] It is remarkable that the examination already ended here and did not even go into the justification level. The Court therefore concluded that granting non-resident taxpayers a choice is discriminatory and disadvantageous compared to national treatment, even if they can opt for

[720] Case C-440/08 *Gielen* [2010] ECR I-2323, paras 1-21.

[721] Case C-440/08 *Gielen* [2010] ECR I-2323, paras 34-55; see also Case C-650/16 *Bevola and Jens W. Trock* [2018] ECLI:EU:C:2018:424.

the most favourable regime. In contrast, in the *National Grid Indus* exit tax case, the Court demanded the exit State to give the emigrating taxpayer a choice between taxation after realisation rather than on relocation and final tax settlement as a special regime.[722]

(h) Granting of Tax Advantages Related to Personal and Family Circumstances: *Meindl* and *Imfeld and Garcet*

Meindl concerned the refusal of the tax authorities to allow Mr Meindl to file a joint tax assessment with his wife. Mr Meindl, an Austrian national resident in Germany, received income in Germany as a self-employed person. His wife, an Austrian national resident in Austria, received a non-taxable confinement allowance, maternity allowance and family allowance in Austria. German law provided for the possibility for spouses who were not permanently separated to opt for joint assessment, but under the condition that they were fully taxable in Germany, i.e. had their permanent residence or habitual abode in Germany. Under certain circumstances, this was also possible for spouses where one of them resides abroad and where at least 90% of the income of both spouses is subject to German income tax or where a certain amount of income not subject to this tax is not exceeded. However, the German tax authority rejected their application for joint assessment on the grounds that the proportion of income received in Germany was below 90% and that the income limit had been reached because Mrs Meindl had received wage compensation benefits from the Austrian State. Consequently, it ruled that Mr Meindl should be subject to the tax applicable to unmarried persons. The referring Court decided to stay the proceedings and to examine whether it is contrary to the freedom of establishment for a resident taxpayer to be refused joint assessment with his spouse living in Austria, from whom he is not separated, on the ground that the spouse has received more than the 10% of the joint income and more than the amount provided for, even though that income is tax exempt under Austrian law.[723]

The ECJ held that Mr Meindl, by being a resident of the State in which he receives all his income, is treated differently from a resident taxpayer whose spouse is also a resident of that MS. Such a taxpayer would indeed be entitled to joint assessment. The Court considered that these situations are objectively comparable, since in both cases the taxable income derives from the activity of only one of the spouses and that spouse is a resident taxpayer. In this context, the Court noted that the residence requirement for the spouse is a requirement that German nationals can more easily meet. In those circumstances, the decision to treat Mr Meindl as a

[722] Case C-371/10 *National Grid Indus* [2011] ECR I-12273, para 73; see also Peter Wattel, 'Non-Discrimination *à la Cour*: The ECJ's (Lack of) Comparability Analysis in Direct Tax Cases' (2015) European Taxation 542, 551.
[723] Case C-329/05 *Meindl* [2007] ECR I-1107, paras 2-19.

single taxpayer, even though he is married and has taxable income in the State of his residence, cannot be justified because his wife has maintained her residence in another MS and has non-taxable income there. The taxpayer's State of residence is the only State that can take into account his personal and family circumstances, which did not happen in the present case and therefore constitutes discrimination.[724]

In *Meindl*, the Court did not follow a clear methodology, but basically analysed all the different steps at once. It started by demonstrating the comparability of situations and then merely found that such treatment could not be justified before even finding that it constituted discrimination. By contrast, in the next case, the ECJ's adapted its language and approach from such imprecise and unclear judgments to an implementation of the individual steps of the test.

The *Imfeld and Garcet* case concerned the calculation of the joint tax liability of a married couple residing in Belgium in respect of income earned in another MS which was tax exempt in Belgium but which served as the basis of assessment for the grant of tax benefits relating to personal and family circumstances, with the result that the couple was deprived of certain advantages to which they would have been entitled if that income had not been taken into account. Mr Imfeld, a German national, and Ms Garcet, a Belgian national, were married and lived in Belgium with their children. They filed separate tax returns in Belgium. Mr Imfeld earned all his income as a lawyer in Germany, having no taxable income in Belgium. There he was entitled to an allowance for children (*Freibetrag für Kinder*). However, he was not entitled to the spousal splitting scheme (*Ehegattensplittung*). Ms Garcet, who worked in Belgium, claimed mortgage interest and childcare costs. The Belgian authorities considered that Ms Garcet could not be considered single and therefore issued a correction notice stating that the applicants would be taxed jointly, taking into account the income of both. Mr Imfeld's income, although fully exempt from tax, was taken into account for childcare costs, income allowances and reductions of replacement income. Hence, the question which arose and was referred to the ECJ was whether the tax treatment accorded by Belgium to the income of a couple residing in that MS, one of whom earns income in that State while the other is self-employed in another MS, where he earns all his income, which is taxable there and exempt from taxation in Belgium, is compatible with the fundamental freedoms.[725]

[724] Case C-329/05 *Meindl* [2007] ECR I-1107, paras 24-32; cf Case C-346/04 *Conijn* [2006] ECR I-6137, in which the Court held that Art 49 TFEU precludes legislation which does not allow a person with limited tax liability to deduct the costs of obtaining tax advice for the preparation of his tax return from his taxable income as special expenses in the same way as a person with unlimited tax liability.

[725] Case C-303/12 *Imfeld and Garcet* [2013] ECLI:EU:C:2013:822, paras 1-31.

The Court first determined which freedom was applicable to the situation and held that, since Mr Imfeld was exercising a liberal profession and self-employed activity, he was not covered by the free movement of workers but by the freedom of establishment. It then went on to consider a restriction. The Court recalled that, in principle, it is for the State of residence to grant the taxpayer all the tax advantages resulting from his personal and family circumstances. The State of employment is obliged to take into account the personal and family circumstances only if the taxpayer earns all or most of his income there and has no significant income in the State of residence. In the present case, personal and family circumstances were taken into account by both Germany and Belgium, at least in part. Under Belgian law, the couple was normally entitled to the income allowance for dependent children, but they did not receive it. The allowance, which could have been exempt from tax, was in fact offset against Mr Imfeld's income. This income was however deducted from the tax base because it was exempt according to the German-Belgian convention, so that ultimately there was no tax-free income allowance. Consequently, the legislation in question penalised couples who earn most of their income in another MS compared to couples who earn all or most of their income in Belgium, thus leading to a difference in treatment depending on the source and level of their income. The purpose of the legislation was actually to maximise the effect of the benefit in favour of the couple as a unit by allocating the allowance to the partner with the higher income, but in a cross-border situation it had the opposite effect. As a result, the couple was deprived of part of the exemptions because one of them had exercised his freedom of establishment. Although Mr Imfeld was granted a tax exemption for dependent children in Germany, this could not be considered to compensate for the loss of the advantage in Belgium. A MS cannot rely on an advantage granted unilaterally by another MS in order to escape its obligations.[726]

As justification, the Belgian government argued that a restriction was justified by the need to preserve the balanced distribution of taxing powers between MS and argued that the State of residence only has to take into account the personal and family circumstances of the taxpayer if there is taxable income in that State. The ECJ ruled that such a justification cannot be invoked to avoid the obligation to grant the taxpayer the allowances to which he is entitled, unless that State is exempted from its obligations by an international agreement. The convention however does not impose on the State of employment the obligation to take into account family and personal circumstances of taxpayers living in the other MS. Moreover, the legislation does not establish a link between the tax advantages granted to residents and the advantages they may

[726] Case C-303/12 *Imfeld and Garcet* [2013] ECLI:EU:C:2013:822, paras 35-63.

enjoy in connection with their taxation in another MS. In the present case, the applicants were not able to claim the allowance because they received an equivalent benefit in Germany, but only because the benefit was nullified by the rules for its offsetting. The Court clarified that the restrictive effect for the couple did not lie in the disadvantageous treatment of Mr Imfeld's tax-free income, but in the disadvantageous treatment of the income of his partner, Ms Garcet, which was earned exclusively in Belgium and was fully subject to Belgian tax without her receiving the tax advantages in question. Since that restriction could not be justified, the Belgian legislation infringed Art 49 TFEU.[727]

(i) Deduction of Losses: *Marks & Spencer* and the final losses doctrine, *A*, *Bevola* and *AURES Holdings*

The famous *Marks & Spencer* ruling dealt with the question of whether the UK was obliged under primary law to open up its domestic group relief system to cross-border situations and losses incurred by foreign subsidiaries in other MS. The Court ruled that such foreign losses could be excluded from the domestic tax base, but that they must be taken into account in certain circumstances in accordance with the principle of proportionality (if the company could prove that the foreign subsidiary has exhausted all possibilities in the State of residence to offset the loss against profits).[728] This doctrine of final or definitive losses was later extended to losses of foreign permanent establishments in the *Lidl Belgium* case.[729]

Case *A* concerned a company under Finnish law (A) that could not deduct the losses of its Swedish subsidiary (B) after its merger. After suffering losses, B did not want to continue its business in Sweden and merged with A, its parent company. A asked the Finnish tax authorities whether it could deduct the losses of B. The authorities denied this on the grounds that B's losses had been determined according to Swedish tax law. On the contrary, if a resident company takes over a Finnish company, it can deduct the losses of that company. Finnish law does not specify the conditions under which that deduction may be made if the acquired company is resident in another MS. The referring court therefore wanted to know whether it is contrary to Art 49 TFEU for a resident parent company to be denied a deduction for the losses of its non-resident subsidiary prior to the merger, whereas such a deduction is allowed when the merger takes place with a resident company.[730]

[727] Case C-303/12 *Imfeld and Garcet* [2013] ECLI:EU:C:2013:822, paras 64-80.
[728] Case C-446/03 *Marks & Spencer* [2005] ECR I-10837.
[729] Case C-414/06 *Lidl Belgium* [2008] ECR I-3601.
[730] Case C-123/11 *A* [2013] ECLI:EU:C:2013:84, paras 1-20.

Several intervening governments considered that the freedom of establishment was not applicable in this case, since the merged company had ceased its economic activity prior to the merger and the only motive for the restructuring was the search for a tax advantage. In response, the Court recalled that cross-border mergers meet the needs of cooperation and consolidation between undertakings in different MS and can thus be considered a specific form of exercise of the freedom of establishment. In this respect, A exercised its right to freedom of establishment by establishing a subsidiary in Sweden. Moreover, the applicability of Art 49 TFEU cannot be denied on the grounds that a merger is motivated only by tax considerations and that companies thus seek to circumvent their national legislation. Hence, Art 49 TFEU was applicable to the present case.[731]

In a next step, the Court examined the existence of an obstacle within the meaning of Art 49 TFEU. It held that the possibility under Finnish law for a resident company to take into account the losses of a resident subsidiary when it merges with the latter constitutes a tax advantage for the parent company. The exclusion of such an advantage for a resident parent company and a non-resident subsidiary makes establishment in the latter State less attractive and discourages companies from establishing subsidiaries there, which constitutes unequal treatment. It then addressed the comparability of the situations, stating that the situation of a resident parent company wishing to merge with a resident subsidiary and benefit from a tax deduction for the losses and the situation of a resident parent company wishing to merge with a non-resident subsidiary are objectively comparable with regard to the objective of the law, which is to grant the parent company a tax advantage in the form of a tax deduction for the losses of the subsidiary.[732] Finally, as regards justification, the governments which had submitted observations considered that the difference in treatment was justified by the need to preserve the allocation of taxing powers and to avert the risk of double use of losses and tax avoidance. The Court held that the preservation of the division of taxing powers might require that only the rules of that State relating to profits and losses be applied to the economic activities of companies resident in a MS. Allowing companies to choose the country in which losses are to be taken into account would call into question this balanced allocation. There is a risk of double use of losses if the parent company resident in another MS is allowed to deduct the losses of its merged subsidiary. The risk of tax avoidance also exists in the case of mergers where the restructuring within a group is organised in such a way that the losses are considered in the MS with the highest tax rate. Hence, the legislation in question pursues legitimate objectives that

[731] Case C-123/11 *A* [2013] ECLI:EU:C:2013:84, paras 21-28.
[732] Case C-123/11 *A* [2013] ECLI:EU:C:2013:84, paras 29-39.

could justify the obstacle. Nevertheless, in a final step, the Court carried out a proportionality analysis. The Court reiterated that a measure is not proportionate if the non-resident subsidiary has exhausted all the possibilities available in the State of residence to have the losses recognised. In this context, A argued that after the completion of the merger and the liquidation of B, so that A no longer had a subsidiary in Sweden, neither had the possibility to claim the losses incurred in Sweden before the merger. The intervening governments, however, considered that the possibility of taking the losses into account in Sweden remained. The Court found that the circumstances before it did not establish that there was no possibility of taking the losses into account in the State of residence and therefore held that it is for the national court to determine whether A established that B exhausted all possibilities of taking the losses into account. If the referring court would conclude that such proof was provided, it would be contrary to Arts 49 and 54 TFEU to deny A the deduction of losses of its non-resident subsidiary. However, those provisions do not preclude legislation under which a parent company which merges with a subsidiary in another MS cannot deduct the losses incurred by that subsidiary prior to the merger, whereas that is allowed where the merger is with a domestic subsidiary.[733]

A few years later, in *Commission v UK*, the Court addressed the (post-*Marks & Spencer*) amended UK legislation on the system of group relief for final losses of subsidiaries resident in other MS, which imposed a heavy burden on parent companies by requiring proof that the foreign subsidiary is unable to obtain loss relief in its country of residence for future accounting periods immediately after the end of the accounting period.[734] Despite criticism of the final losses doctrine by various AGs,[735] the Court confirmed its *Marks & Spencer* judgment and also the amended UK legislation. Subsequently, in *Timac Agro,* the Cologne Fiscal Court asked the ECJ to clarify its doctrine. This case concerned a German company that suffered losses through a permanent establishment in Austria. Thanks to a relief scheme, it was able to use the loss to reduce its tax base. However, following the sale of the permanent establishment to an Austrian subsidiary, the deducted loss was recaptured. The German company argued that the other losses accumulated over the years by the permanent establishment fell under the doctrine established in *Marks & Spencer* and *Lidl Belgium*.[736] The ECJ found that permanent establishments

[733] Case C-123/11 *A* [2013] ECLI:EU:C:2013:84, paras 40-56.
[734] Case C-172/13 *Commission v UK* [2015] ECLI:EU:C:2015:50.
[735] Case C-123/11 *A* [2012] ECLI:EU:C:2012:488, Opinion of AG Kokott, paras 47ff; Case C-322/11 *K* [2013] ECLI:EU:C:2013:183, Opinion of AG Mengozzi, paras 80ff; Case C-172/13 *Commission v UK* [2014] ECLI:EU:C:2014:2321, Opinion of AG Kokott, paras 42ff.
[736] Case C-388/14 *Timac Agro Deutschland* [2015] ECLI:EU:C:2015:829, paras 1-18.

established in a MS other than the MS concerned are not in a comparable situation to resident permanent establishments with regard to the measures provided for by that MS to prevent or mitigate double taxation of profits. However, by allowing the deduction of losses of foreign permanent establishments, Germany puts the tax situation of these foreign permanent establishments on an equal footing with that of domestic ones. In this respect, the recapture mechanism leads to unequal treatment. As justification, the Court accepted the need to safeguard the symmetry between the right to income taxation and the right to deduct losses, the coherence of the national tax system and the prevention of tax avoidance. With regard to proportionality, the Court referred briefly to *Marks & Spencer* and *Commission v UK*, but ultimately left it to the national court to decide whether the losses incurred were definitive and final. Concerning the losses of the tax-treaty exempt Austrian permanent establishment, it merely stated that the situations of permanent establishments in Austria and in Germany are not comparable in relation to measures to prevent or mitigate double taxation of profits.[737] As a result, the German courts considered the *Lidl Belgium* doctrine to be overruled.[738] The next case on this issue was already pending before the ECJ at the time.

Bevola concerned the refusal of the Danish authorities to allow Bevola, established in Denmark, to deduct the losses of its Finnish subsidiary, which it had closed. The authorities refused the request to deduct losses in Denmark on the grounds that Danish law does not permit the inclusion in taxable income of income and expenses relating to a permanent establishment or a property situated abroad (territorial regime), unless the company has opted for international joint taxation. Bevola challenged that decision, claiming an infringement of Art 49 TFEU on the ground that there was no possibility of taking into account the losses of its Finnish establishment when it had exhausted all possibilities of taking those losses into account in the State of establishment. The referring court therefore referred the question of the compatibility with Art 49 TFEU of national law under which a resident company cannot deduct losses from a permanent establishment in another MS, even if those losses can no longer be taken into account in that MS, unless the resident company has opted for a scheme of joint international

[737] Case C-388/14 *Timac Agro Deutschland* [2015] ECLI:EU:C:2015:829, paras 19ff.

[738] Eg Finanzgericht München, 7V 3044/15, *Entscheidungen der Finanzgerichte* 2016, 1232, ECLI:DE: FGMUENC:2016:0531.7V3044.15.0A; Bundesfinanzhof, I R 2/15, *Bundessteuerblatt* II 2017, 709, ECLI:DE:BFH:2017:U.220217.IR2.15.0; for more on cross-border loss compensation see Axel Cordewener, 'Cross-Border Loss Compensation and EU Fundamental Freedoms: The 'Final Losses' Doctrine Is Still Alive!' (2018) EC Tax Review 230.

taxation. Opting for such a scheme means that all companies in the group (resident or non-resident), including permanent establishments, are taxable in Denmark.[739]

The ECJ first held in general terms that taking into account losses from a permanent establishment in the MS of the parent company, but not losses from a permanent establishment in a MS other than that of the resident parent company, results in the tax situation of a resident company with a permanent establishment in another MS being less favourable and constitutes a difference in treatment. As regards the existence of a difference in treatment in the present case, the Court continued to find such difference, since the losses of the non-resident permanent establishment, which has ceased its activities, could not be deducted in the MS in which it was situated, whereas this would be possible if the permanent establishment were situated in Denmark. The fact that, under the optional scheme, a Danish company can deduct the losses of its permanent establishment in another MS in the same way as resident losses does not call that finding into question. This is because the relief is subject to two conditions: The entire income of the group must be subject to corporation tax in Denmark and the option is valid for a minimum period of ten years.[740] In examining the comparability of the situations, the Court took into account the objective pursued by the national provision of preventing double taxation of profits and double deduction of losses, as well as the more general aim of ensuring taxation according to the ability to pay. In this context, the Court held that the situation of a company with a non-resident permanent establishment which has incurred losses is objectively comparable to the situation of a company with a resident permanent establishment which has incurred losses. This is the case because the ability to pay taxes is affected in the same way.[741]

In a further step, the Court examined the justifications. With regard to a balanced allocation of taxing powers, it found that extending the loss deduction to non-resident permanent establishments would undermine it, as the tax base would be increased in one MS and reduced in another, depending on the company's choice. With regard to the coherence of the tax system, the necessary direct link between the advantage and its offsetting was considered to exist. Furthermore, the Court noted in an obiter dictum that the prevention of the risk of double use of losses was also capable of justifying the restriction.[742] In the proportionality test, the Danish legislation was found to go beyond what is necessary to pursue the objectives, since the risk of double deduction of losses ceases to exist when the losses of a non-resident permanent

[739] Case C-650/16 *Bevola and Jens W. Trock* [2018] ECLI:EU:C:2018:424, paras 7-14.
[740] Case C-650/16 *Bevola and Jens W. Trock* [2018] ECLI:EU:C:2018:424, paras 19-29.
[741] Case C-650/16 *Bevola and Jens W. Trock* [2018] ECLI:EU:C:2018:424, paras 30-40.
[742] Case C-650/16 *Bevola and Jens W. Trock* [2018] ECLI:EU:C:2018:424, paras 41-54.

establishment can no longer be deducted in the MS in which it is established. In line with the AG opinion,[743] the Court applied its ruling in *Marks & Spencer* by analogy and stated that the losses attributable to a non-resident permanent establishment become definitive when the parent company has exhausted all possibilities of deduction in the MS of residence of the permanent establishment and when it no longer derives income from that establishment, so that the losses can no longer be taken into account in that MS. Ultimately, it is up to the national court to decide whether these conditions are met.[744]

AURES Holdings concerned the refusal of the Czech tax authorities to allow AURES Holdings, a company resident and taxable in the Netherlands, to deduct tax losses it had incurred in a MS other than the Czech Republic. In 2007, AURES had incurred a loss in the Netherlands before establishing a permanent establishment in the Czech Republic and transferring its place of effective management there in 2008. It maintained, however, its registered seat and its entry in the commercial register in the Netherlands. In view of this change of place of effective management and its tax residency, AURES applied to the Czech tax authorities for a deduction of the loss incurred in the Netherlands. The Czech authorities refused to deduct the loss on the grounds that only losses arising from an economic activity in the Czech Republic can be deducted from the tax base, as the law does not regulate such a deduction in the event of a change of tax residence and does not provide for the transfer of such a loss from a MS other than the Czech Republic. The Supreme Administrative Court decided to stay the proceedings and to refer the question whether a simple transfer of the place of management of a company falls within the scope of Art 49 TFEU and whether this provision prohibits refusing to allow a company transferring its registered office from another MS to claim a tax loss incurred in that other MS.[745]

First, as regards the application of Art 49 TFEU to the present case, the Court referred to *National Grid Indus*,[746] where it held that a company incorporated under the law of a MS which transfers its place of effective management to another MS without affecting its status as a company of the first MS may rely on Art 49 TFEU to challenge the tax consequences arising from that transfer. Thus, a cross-border transfer of the place of management falls within the

[743] Case C-650/16 *Bevola and Jens W. Trock* [2018] ECLI:EU:C:2018:15, Opinion of AG Campos Sánchez-Bordona, paras 37-39.
[744] Case C-650/16 *Bevola and Jens W. Trock* [2018] ECLI:EU:C:2018:424, paras 55-66; similarly Case C-607/17 *Memira Holding* [2019] ECLI:EU:C:2019:510; Case C-608/17 *Holmen* [2019] ECLI:EU:C:2019:511.
[745] Case C-405/18 *AURES Holdings* [2020] ECLI:EU:C:2020:127, paras 1-22.
[746] Case C-371/10 *National Grid Indus* [2011] ECR I-12273, para 33.

scope of this provision.[747] Second, in relation to the infringement of Art 49 TFEU, the Court held that the Treaty does not guarantee a company that the transfer of its place of management across borders is tax neutral. The Court held that the possibility for a resident company to claim a loss incurred in a MS in a given tax year in order to deduct that loss from taxable profits in subsequent tax years constitutes an advantage. It constitutes a difference in treatment if a loss suffered by a company resident in one MS but incorporated in another MS during the tax year in which that company was resident in the MS of incorporation is excluded from the benefit of that relief, whereas the relief is granted to a company resident in the host MS which suffered a loss in the same tax year. A company could be deterred from transferring its place of management to another MS. The Court then considered whether the situations were objectively comparable or justified. The Court considered that the Czech legislation helps to preserve the division of taxing powers and to prevent the risk of double deduction of losses by refusing to allow a company to deduct a loss incurred in a tax year in which it was resident in another MS. It considered that a company which suffers a loss in its State of residence and a company which transfers its place of management after having incurred a loss in another MS are not in a comparable situation. This is because the company making the transfer is successively subject to the tax jurisdiction of two MS, so that there is a greater risk of the loss being taken into account twice. It follows that the home MS of a company may tax unrealised capital gains of a company incorporated under its laws which has transferred its place of effective management to another MS. The host MS cannot be required to take into account the loss incurred before the transfer which related to tax years in which the company did not fall within its tax jurisdiction. Since the situations were not comparable, there was no infringement of Art 49 TFEU.[748]

In summary, the Court affirmed comparability in *A*, while denying it in *Aures Holdings*. Although the facts of the two cases are quite similar, where the losses occurred before the merger or the transfer of the administrative seat, the Court reached different conclusions.

[747] Case C-405/18 *AURES Holdings* [2020] ECLI:EU:C:2020:127, paras 23-28.

[748] Case C-405/18 *AURES Holdings* [2020] ECLI:EU:C:2020:127, paras 29-54; see also Case C-686/13 *X* [2015] ECLI:EU:C:2015:375, which concerned the Swedish tax authorities' refusal to grant a Swedish company a deduction for a currency loss arising from the disposal of shareholdings in a UK-based subsidiary. In this case, the Court held that MS are not obliged to adapt their tax systems to take account of possible exchange rate risks for companies and therefore do not infringe Art 49 TFEU by exempting capital gains from shareholdings and excluding the deduction of capital losses from such holdings, even if those losses are due to currency losses; similarly Case C-538/20 *W (Déductibilité des pertes définitives d'un établissement stable non-résident)* [2022] ECLI:EU:C:2022:717, in which the Court ruled that a German company with a permanent establishment in the UK is not in a comparable situation to a German company with a permanent establishment in Germany, since Germany has waived its power to tax permanent establishments in the UK through which their resident companies carry on commercial activities.

Interestingly, AG Kokott argues in her opinion that the objective comparability test is superfluous and must give way to a comprehensive justification analysis.[749] She has repeatedly argued in favour of dispensing with the comparability analysis altogether, arguing that the Court's assessment of the range of criteria to be applied is not transparent and that all situations are comparable in some way.[750] AG Hogan, however, disagrees and considers this to be a necessary step.[751]

(j) Progressive Taxation: *Hervis Sport* and *Vodafone*

Hervis Sport dealt with a highly progressive scale of special taxes introduced by Hungary on the turnover of certain retail sectors. Hervis, which operates sports shops in Hungary, is a subsidiary of SPAR and thus part of the SPAR group as a linked undertaking. On this basis, Hervis was obliged to pay a share corresponding to its turnover of the special tax payable by all companies in the group on the basis of their total turnover generated in Hungary. Hence, Hervis was subject to a higher average tax rate than that resulting from the tax base consisting exclusively of the turnover of its own stores. Hervis argued that such a special retail tax for companies with a turnover of more than HUF 500 million was discriminatory taxation and only affected non-resident companies, whereas Hungarian retail chains did not belong to a group and were therefore not affected.[752]

The Court had to decide whether Art 49 TFEU precludes legislation on a turnover tax where that tax has potentially discriminatory effects in relation to taxable legal persons who, within a group of companies, are linked to a company whose registered office is in another MS. The Court noted that the Hungarian legislation provides a criterion for distinguishing between taxable persons subject to the special tax who are linked to other companies in a group of companies and taxable persons who are not part of a group of companies. This criterion would not be directly discriminatory if it were applied in the same circumstances to all companies. However, it has the effect of discriminating against companies linked to other companies within a group, since, on the one hand, a highly progressive tax rate is levied on turnover and, on the other hand, a scale is applied to the consolidated turnover of linked taxpayers of the group. In this context, it found that the situation of a taxable person belonging to a group is similar to that of a taxable person not belonging to such a group, since both legal persons operate in the retail

[749] Case C-405/18 *AURES Holdings* [2019] ECLI:EU:C:2019:879, Opinion of AG Kokott, para 30.

[750] Cf Case C-48/13 *Nordea Bank* [2014] ECLI:EU:C:2014:153, Opinion of AG Kokott, para 28; Case C-608/17 *Holmen* [2019] ECLI:EU:C:2019:9, Opinion of AG Kokott, para 38.

[751] Case C-388/19 *Autoridade Tributária e Aduaneira (Impôt sur les plus-values immobilières)* [2020] ECLI:EU:C:2020:940, Opinion of AG Hogan; Case C-480/*19 Veronsaajien oikeudenvalvontayksikkö (Revenus versés par des OPCVM)* [2020] ECLI:EU:C:2020:942, Opinion of AG Hogan.

[752] Case C-385/12 *Hervis Sport* [2014] ECLI:EU:C:2014:47, paras 1-28.

market of the same MS and are subject to the special tax. In those circumstances, the application of the steeply progressive rate to consolidated turnover penalises and indirectly discriminates against taxpayers linked to companies established in another MS and thus falling within the highest band. No reasons had been put forward by the Hungarian government to justify this.[753]

Similarly, *Vodafone* concerned a Hungarian special tax on turnover in the telecommunications sector. Vodafone, a company under Hungarian law operating in the telecommunications market, is held by Vodafone Europe BV, based in the Netherlands. The Hungarian subsidiary is part of the Vodafone group based in the UK. The subsidiary is the third largest Hungarian company in the telecommunications market with a market share of more than 20%. During a tax audit, Vodafone was required to pay the special tax based on turnover, which is calculated according to a scale with progressive rates for different bands. In practice, only the Hungarian subsidiaries of foreign parent companies were subject to the tax at the rate of the highest turnover band. The referring court therefore wanted to know whether this effect was indirectly discriminatory.[754]

The Court found that the special sectoral tax scheme at issue does not distinguish between companies according to their place of establishment. All undertakings operating in the telecommunications sector in Hungary are subject to that tax and the tax rates applicable to the various bands of turnover apply to all such undertakings. However, similar to *Hervis Sport*, the applicant and the Commission argued that the fact that the special tax was progressive favoured Hungarian taxpayers and disadvantaged foreign taxpayers. The Court confirmed that the majority of the special tax is borne by foreign-owned taxpayers. However, it also noted that the application of progressive taxation is left to the discretion of MS and that the amount of turnover is a neutral criterion of differentiation and a relevant indicator of ability to pay. Therefore, the fact that the greater part of the tax is borne by foreign-owned companies cannot be classified as discrimination. Finally, the Court showed why the present case was different from *Hervis Sport*. That case concerned the combined application of very progressive tax rates of turnover and a rule for the consolidation of turnover of linked undertakings, which resulted in companies belonging to a group being taxed on fictitious turnover.[755]

Although the cases are very similar and both deal with progressive taxation, the outcome is very different. In *Hervis*, the progressive tax rate was considered a restriction, as only companies

[753] Case C-385/12 *Hervis Sport* [2014] ECLI:EU:C:2014:47, paras 29-45.
[754] Case C-75/18 *Vodafone Magyarország* [2020] ECLI:EU:C:2020:139, paras 1-17.
[755] Case C-75/18 *Vodafone Magyarország* [2020] ECLI:EU:C:2020:139, paras 38-56; similarly Case C-323/18 *Tesco-Global Áruházak* [2020] ECLI:EU:C:2020:140; for a case on the consolidation of the results of group companies and tax integration, see also Case C-749/18 *B and Others (Vertical and horizontal tax integration)* [2020] ECLI:EU:C:2020:370.

belonging to a foreign group with a high turnover were affected and fell into the highest tax bracket. In *Vodafone*, on the other hand, the Court emphasised the importance of progressivity as a competence of the MS and as a suitable instrument for implementing the principle of ability to pay.

4.3.2.2. Interim Conclusion on the Freedom of Establishment

In its extensive case law, the Court constantly changes its language and uses the terms discrimination, restriction, impediment and unequal treatment interchangeably. Unlike the free movement of workers, where comparability is embedded in the analysis of restriction, comparability in the context of the freedom of establishment is a separate step between the determination of the restriction and the justification. As such, the Court can easily find a restriction or discrimination. In practice, in a first step, the Court simply declares the measure in question restrictive, e.g. by finding that non-resident taxpayers do not have the same advantage as resident taxpayers (*Montag*). Only after this rather simple statement does it compare the situation of residents and non-residents. In *Deister*, it found that there was a restriction because the exemption from withholding tax was subject to certain conditions. Only in a second step did it verify whether domestic companies were also affected, which should have already been assessed in the first step. A good example of the methodology in the context of freedom of establishment is the *Bevola* case, which concerned the denial of the deduction of final losses of a foreign subsidiary on the grounds that national law does not allow the recognition of income and expenses relating to permanent establishments or immovable property located abroad, unless the company has opted for international joint taxation. The Court found that taking into account losses from permanent establishments in the MS of the parent company, but not losses in a MS other than that of the resident parent company, constituted unequal treatment. Only then did it formally compare the situations, taking into account the objective pursued by the national provision. In this context, it concluded that the situation of a company with a non-resident permanent establishment and a company with a resident permanent establishment, both making losses, is objectively comparable. As regards justification, the Court accepted the reasons put forward by the Danish government. However, the legislation ultimately failed the proportionality test.[756]

In some cases, the Court does not carry out a proper comparability analysis, but merely refers to the disadvantage of certain measures and rules and even avoids an explicit reference (*de Lasteyrie du Saillant*). Sometimes the Court comes to inconsistent, even contradictory

[756] Case C-650/16 *Bevola and Jens W. Trock* [2018] ECLI:EU:C:2018:424.

conclusions, e.g. when it states that multinational groups cannot be compared to domestic groups, but still considers Art 49 TFEU to be infringed (*Thin Cap Group Litigation*). In *Gielen*, the Court exceptionally first assessed the comparability of the situations, as in the case of the free movement of workers.

As regards the content of the comparability criterion, there is indeed a similarity with the free movement of workers, namely that resident and non-resident taxpayers become comparable if non-residents earn all or most of their income in the same MS. Hence, the same benefits must be granted as for resident taxpayers and personal and family circumstances must be taken into account. Moreover, comparability is given if the expenditure in question is directly linked to the activity giving rise to the taxable income, as is the case with pension contributions. Any excess amount is not directly linked as it is not necessary for the performance of the activity. When examining comparability, the Court focuses on the objective of the measure or provision. This can be viewed as a point of attack in the analysis because it means that the ECJ is scrutinising national law and its objectives. It is unlikely to rely solely on the stipulations put forward by the State and the parties.

At the level of justification, the argument that there are other advantages (abroad or in the same country) cannot compensate for a restriction or discrimination. Even the possibility of opting for a regime does not make up for the discriminatory effects of the law as such and cannot serve as justification. Sometimes the comparability analysis is even merged with the justification analysis when the objective of the measure is considered in this context. It is striking that far too little attention is paid to the proportionality assessment, despite its great importance for States.

The finding of a restriction and a difference in treatment necessarily and inevitably implies a comparison. Currently, according to the Court, a different treatment always appears to be a restriction without comparability really having been examined. Thus, it makes much more sense to include the comparability in the first step of the test when a restriction is identified, as is the case with the free movement of workers. Such an approach would also be less repetitive and would interfere less with the competence of the MS in the field of taxation, as the automatic finding of unequal treatment basically calls into question any and every national tax measure. The Court does not appear to have found a clear and consistent methodology for the freedom of establishment. This is well illustrated by the *Meindl* and *Imfeld and Garcet* cases, which concern the same category of taxes. The two cases show a big difference in the analysis, because in one case there is no clear methodology and in the other case the examination is carried out step by step and very comprehensively.

4.3.3. Arts 56 and 57 TFEU – Freedom to Provide Services

The freedom to provide services enshrined in Art 56 TFEU differs from the freedom of establishment in that it is intended to facilitate the exercise of economic activities in other MS without requiring the establishment of a fixed or permanent base there. The scope of protection is defined in Art 57(1) TFEU, according to which services include those which are normally provided for remuneration, insofar as they are not subject to the free movement of goods, capital or persons. The second paragraph then lists some standard examples. This means that, according to Arts 56ff TFEU, an economic activity is carried out on a temporary basis and does not constitute the establishment of a business.[757] The case law concerning direct tax measures is devoted more to the freedom of establishment than to the freedom to provide services. This is because differences and restrictions in the taxation of companies (and individuals) are more likely and more frequent when they are established for a longer period in another MS.

4.3.3.1. ECJ Case Law on the Freedom to Provide Services

This chapter reviews important judgements of the ECJ on the freedom to provide services that deal with tax measures affecting cross-border service providers within the EU. The selection of cases is organised into four significant categories, namely residence or territory requirements, withholding taxes, gambling income and the situation of concurrent violations of Arts 49 and 56 TFEU. After an intensive search of the case law, it is striking that this fundamental freedom is least invoked in cases of direct taxation, which is why fewer cases are presented. Again, the selected topics are recurring in the case law and are further explained and proven in the footnotes. In this case too, it makes sense to analyse examples of both older and more recent representative case law.

(a) Residence or territory requirement: *Van Binsbergen* and *Safir*

One of the most prominent earlier cases is the *Van Binsbergen* judgment. According to Dutch law, only Dutch residents were able to act as legal representatives or advisers. Mr van Binsbergen authorised Mr Kortmann, a Dutch national and resident, to represent him in court. In the course of the proceedings, Mr Kortmann moved his residence from the Netherlands to Belgium and was therefore informed that he could no longer represent Mr van Binsbergen. Before the court, Mr Kortmann invoked a violation of the freedom to provide services. The

[757] Jonathan Tomkin, 'Article 56 TFEU' in Manuel Kellerbauer, Marcus Klamert and Jonathan Tomkin (eds), *The EU Treaties and the Charter of Fundamental Rights: A Commentary* (OUP 2019) 709.

referring court asked the ECJ whether (now) Art 56 TFEU was directly applicable and, in essence, wished to know whether the requirement that the legal representatives be permanently established in the territory of the State in which the service is to be provided can be reconciled with the prohibition of any restriction on the freedom to provide services.[758]

The Court held in general that the restrictions prohibited by Arts 56 and 57 TFEU include any requirement imposed on the provider by reason of his nationality or habitual residence which does not apply to persons established in the national territory or which is liable to prevent or hinder the activities of the provider. In particular, the requirement of habitual residence in the State where the service is provided may have the effect of depriving Art 56 TFEU of any useful effect, since the aim of that provision is to allow persons who are not resident in a particular State to provide their services there. However, it also held that, in view of the specific nature of certain services, specific requirements imposed on the service provider cannot be regarded as incompatible if they have as their object the application of professional rules justified by the general interest (e.g. rules of professional ethics or rules of qualifications) which are binding on any person established in the State in which the service is provided, whereas the provider would escape those rules by being established in a different MS. Accordingly, the requirement that persons participating in the administration of justice be permanently established for professional purposes within the jurisdiction of certain courts is compatible with Art 56 TFEU if it is objectively justified by the need to ensure compliance with professional rules of conduct. However, this is not the case if the provision of certain services is not subject to any qualification or regulation. The requirement of residence in that State is incompatible where less restrictive measures are available, such as the choice of a service address.[759] Furthermore, the Court confirmed the direct effect of Arts 56 and 57(3) TFEU.[760]

In *Safir*, the Court did not use the term discrimination, but merely spoke of deterrence. *Safir* concerned the taxation of capital life insurance premiums paid by Mrs Safir to Skandia Life Assurance, a British insurance company operating on the Swedish market and wholly owned by the Swedish insurance company Skandia. Mrs Safir applied for an exemption from tax on insurance premiums, which was refused by the Swedish authorities.[761] The ECJ first confirmed that the provision of insurance constitutes a service within the meaning of Art 56 TFEU. It then found that the Swedish rules provided for different tax regimes for capital life assurance policies

[758] Case C-33/74 *Van Binsbergen* [1974] ECR 1299, paras 1-9.
[759] Case C-33/74 *Van Binsbergen* [1974] ECR 1299, paras 10-17.
[760] Case C-33/74 *Van Binsbergen* [1974] ECR 1299, paras 18-27.
[761] Case C-118/96 *Safir* [1998] ECR I-1897, paras 2-19.

depending on whether they are taken out with companies established in Sweden or elsewhere. Individuals who have taken out capital life assurance with companies established abroad had to register themselves, report the premium payments to a central body and pay the tax themselves. These obligations discourage persons from opting for capital life assurance offered by companies outside Sweden, since in the case of taking out such insurance with a company in Sweden, no special measures are required and the tax is levied on the company. Moreover, the tax authorities required precise information on the income tax to which the company is subject, which also discourage insurance companies not operating in the Swedish market from offering their services there. Swedish legislation also provided that the determination of the applicable tax depends on the tax regime applicable to the insurer, which creates legal uncertainty. Although the tax applicable in another MS must be taken into account, there was nevertheless a threshold effect, as the payment of such a tax was not taken into account unless it was at least one quarter of the tax applicable in Sweden. A restriction was thus established.[762] The Court noted that less restrictive systems were conceivable, such as a system of taxation of investment income from life assurance policies calculated according to a standard model applicable in the same way to all insurance policies, regardless whether a domestic or foreign company is involved. The justification put forward by Sweden, which was that it is not possible to apply the same policies to domestic and foreign companies and that the tax vacuum resulting from the non-taxation of savings in the form of capital life assurance policies abroad must be filled, could not therefore be upheld.[763]

(b) Withholding Tax: *Brisal*, *TTL* and *Airbnb Ireland and Airbnb Payments UK*

Brisal concerned the calculation of corporate income tax on interest income and its collection at source. Brisal, a company established in Portugal, and KBC, a bank established in Ireland, entered into an external financing agreement to ensure the performance of all activities covered by a concession agreement concluded with the Portuguese State. The consortium of banks involved was extended to include foreign banks such as KBC. Brisal and KBC argued that interest received by non-resident financial institutions in Portugal is subject to a withholding tax of 20% or a lower rate provided for in a DTC, whereas interest received by resident financial institutions, which is not subject to withholding tax, is taxed at 25% on its net value. Hence,

[762] Case C-118/96 *Safir* [1998] ECR I-1897, paras 22-33.
[763] Case C-118/96 *Safir* [1998] ECR I-1897, paras 34-36; see also Case C-17/00 *De Coster* [2001] ECR I-9445, on a municipal tax on satellite dishes for receivers of television services from other MS; Case C-39/04 *Laboratoires Fournier* [2005] ECR I-2057, on the limitation of a research tax credit to research only carried out in that MS; cf Case C-387/22 *Nord Vest Pro Sani Pro* [2024] ECLI:EU:C:2024:786, on the tax treatment of foreign construction workers in relation to tax and social benefits.

non-resident financial institutions are more heavily taxed than resident financial institutions. The question arose whether legislation that taxes non-resident financial institutions with a withholding tax on interest income received domestically without the possibility of deducting operating expenses, while resident financial institutions are no subject to a withholding tax and can deduct operating expenses directly related to the financial activity carried out, is compatible with Art 56 TFEU.[764]

First, the Court recalled its previous case law according to which withholding taxes on non-resident service providers, where resident service providers are not subject to that tax, may constitute a restriction of Art 56 TFEU, but may be justified by overriding reasons in the general interest.[765] It then held that a regime such as the one at issue is not precluded by the freedom to provide services if the application of the withholding tax to non-resident financial institutions is justified by an overriding reason relating to the public interest and is proportionate. In this respect, the Court merely stated that resident and non-resident operators are in a comparable situation. Consequently, the services provided by financial institutions cannot be treated differently from the provision of services in other sectors of activity. The Portuguese legislation therefore constituted a restriction of Art 56 TFEU.[766] The ECJ then considered possible justifications. First, the argument that other potential advantages exist cannot be upheld, as a restriction cannot be justified by the fact that non-resident financial institutions are subject to a tax rate that is lower than the tax rate applicable to resident financial institutions. Second, as regards the preservation of a balanced allocation of taxing powers, it is not possible to explain in the present case how this allocation requires that non-resident financial institutions be treated less favourably than resident ones as regards the deduction of operating expenses related to their taxable income. Concerning the prevention of double deduction of expenses, this potential risk can be avoided through the mutual assistance between the competent authorities in the MS. Portugal has not put forward any arguments to prove the contrary. Next, pertaining to the effective collection of tax and the additional administrative burden on the authorities, it is sufficient to note that the same burden applies to unlimited taxable persons. Concerning the additional administrative burden for the service recipient in relation to the business expenses claimed for deduction, this only exists if the deduction has to be made before the withholding tax is applied and can be avoided if the service provider is entitled to claim his right to deduct directly from the authorities. It follows that non-residents must be treated in the same way as

[764] Case C-18/15 *Brisal and KBC Finance Ireland* [2016] ECLI:EU:C:2016:549, paras 2-28.
[765] Case C-18/15 *Brisal and KBC Finance Ireland* [2016] ECLI:EU:C:2016:549, paras 17-22.
[766] Case C-18/15 *Brisal and KBC Finance Ireland* [2016] ECLI:EU:C:2016:549, paras 23-29.

residents and allowed to deduct the same expenditure. Expenses relating to income earned in the MS in which the service is provided must be understood as expenses occasioned by and necessary to the activity. It is for the national court to assess which expenses can be considered directly linked to the activity. In the present case, the granting of a loan necessarily leads to business expenses for which it is relatively easy to establish a direct link and to prove the amount. The authority is not prevented from requiring such proof from a non-resident and Portugal has not put forward any reasons preventing the authorities from taking into account the evidence of non-resident financial institutions.[767]

The *TTL* case concerned contracts for the lease of rail tankers concluded between TTL, a Bulgarian company, on the one hand, and unrelated Dutch, Austrian and Polish companies on the other, including the income paid to these three companies as consideration for the lease. As TTL considered that the income was covered by DTCs, it did not deduct withholding tax. The three non-resident companies did not request a decision on the applicability of the relevant DTCs, but only submitted evidence of compliance with the conditions for the application of these conventions. The tax adjustment notice issued by the Bulgarian authorities confirmed that the Dutch and Austrian companies were not taxable in Bulgaria, but that the income paid to the Polish company should have been taxed at a withholding rate of 5% and that interest was due on the unpaid withholding tax. Under Bulgarian law, a resident company paying income subject to withholding tax is liable to pay interest if the company resident in another MS receiving that income has not shown that the conditions for the application of the DTCs are met, even if that non-resident company is not liable to pay tax in Bulgaria or the amount is lower than that normally payable under Bulgarian law. The referring court wondered whether such a provision leads to a restriction of fundamental freedoms.[768]

As the transaction in question concerned the leasing of tankers, the Court clarified that the freedom to provide services was the relevant freedom here. The Court found that resident undertakings paying income in return for the provision of services are treated differently depending on whether the company receiving that income is another company established in Bulgaria or in another MS. This constitutes an obstacle to the free movement of services.[769] In a further step, the Court examined the justifications of effective tax collection and the need to

[767] Case C-18/15 *Brisal and KBC Finance Ireland* [2016] ECLI:EU:C:2016:549, paras 30-55; see also Case C-433/04 *Commission v Belgium* [2006] ECR I-10653, which concerned a breach of Art 56 TFEU by obliging principals and contractors not registered in Belgium to withhold tax and imposing joint and several liability for tax debts on them.
[768] Case C-553/16 *TTL* [2018] ECLI:EU:C:2018:604, paras 14-29.
[769] Case C-553/16 *TTL* [2018] ECLI:EU:C:2018:604, paras 40-51.

ensure the effectiveness of fiscal supervision and found that they appear to justify the imposition of penalties on companies which do not pay the taxes within the prescribed period and which do not submit in due time the documents proving that they may claim exemption from the obligation to pay those taxes. However, a penalty in the form of irrecoverable interest is not appropriate to achieve these objectives if the tax is not due under the relevant convention and there is no link between the interest and the tax due. Moreover, such a sanction goes beyond what is necessary, as the amount of interest accrued may prove to be excessive compared to the amount of tax due and no possibility of reimbursement of such interest is provided for. The amount of interest for late payment of the tax remains the same regardless of whether the tax was not paid at all or not paid on time. The Bulgarian legislation therefore infringed Art 56 TFEU.[770]

Airbnb Ireland and Airbnb Payments UK addressed an Italian provision on the tax regime for real estate intermediary services related to short-term rentals. The applicants operated the online rental portal Airbnb, which facilitates the connection between landlords who have accommodation and persons seeking accommodation by collecting payment from the customer for the provision of the accommodation before the rental begins and transferring this payment to the landlord after the rental begins. The applicants contested the applicable Italian tax regime, which provided for an obligation to transmit contract data, a withholding tax and the obligation to appoint a tax representative in the event that a person operating an online property intermediation portal is not resident or established in Italy. The ECJ was asked about the conformity of these measures in the light of Art 56 TFEU.[771]

The Court first analysed the obligation to collect and transmit data on rental contracts to the tax authorities and found that this obligation is imposed on all third parties involved in short-term property rental in Italy, irrespective of their status as legal or natural persons, their residence in the territory or not, and their actions through digital or other means of contact. As this regime is part of an overall strategy to combat the frequent tax avoidance in the short-term rental sector and applies to all service providers, it cannot be considered discriminatory. The fact that mainly online platforms outside Italy are affected does not call this finding into question, as the larger obligation merely reflects the larger number of transactions of these intermediaries and their respective market shares. Secondly, as regards the obligation to withhold tax on the sums paid by tenants to landlords on behalf of the tax authority, the Court considered that the burden is no

[770] Case C-553/16 *TTL* [2018] ECLI:EU:C:2018:604, paras 52-63.
[771] Case C-83/21 *Airbnb Ireland and Airbnb Payments UK* [2022] ECLI:EU:C:2022:1018, paras 2-22.

greater for providers of property intermediation services established in a MS other than Italy than for undertakings in Italy. The same withholding tax obligations apply to them.[772]

However, the obligation to appoint a tax representative in Italy does not apply to all service providers, but only to certain providers without a permanent establishment in Italy. Thus, providers are treated differently depending on whether or not they have a permanent establishment in Italy. The cost of remunerating a representative may discourage service providers from providing their services in Italy, so that such an obligation constitutes a restriction of Art 56 TFEU. As justification, the Court found that the obligation to appoint a tax representative in Italy is part of the pursuit of the objective of combating tax avoidance in the short-term rental sector and ensuring the effective collection of taxes. As providers are responsible for withholding tax on behalf of the authorities, they want to ensure that this task is successfully fulfilled and that the amounts are properly transferred to the tax authority. Therefore, the obligation pursues a legitimate objective and is justified by overriding reasons in the public interest. Moreover, the Court found that the obligation is suitable for achieving the objectives. The Court highlighted that the use of intermediary services on online portals has increased exponentially and that services are provided online across borders, which corresponds to rental transactions that have a precise physical location and can be taxed under the law of the MS concerned. These rentals are often of short duration, whereby the same property may be rented out several times in the course of a tax year between landlords and tenants from MS other than that of the place where the property is situated. In a final step, the Court examined whether the obligation did not go beyond what was necessary to achieve the objective. The Court found that the obligation applies indiscriminately to all providers of property intermediation services who do not have a permanent establishment in Italy, without distinction as to the amount of tax revenue collected or to be collected. Hence, that obligation goes beyond what is necessary to achieve the objectives of that regime and thus infringes Art 56 TFEU.[773]

(c) Income from winnings from gambling: *Blanco and Fabretti*

The joined cases *Blanco and Fabretti* concerned similar situations where the applicants made profits from casinos in MS other than Italy. The Italian authorities considered that these amounts should have been included in their taxable income and therefore subjected Mr Blanco and Mr Fabretti to a tax adjustment. In his contestation, Mr Blanco relied on the judgement in *Lindman*, in which the Court had held that Art 56 TFEU precludes legislation under which

[772] Case C-83/21 *Airbnb Ireland and Airbnb Payments UK* [2022] ECLI:EU:C:2022:1018, paras 42-55.
[773] Case C-83/21 *Airbnb Ireland and Airbnb Payments UK* [2022] ECLI:EU:C:2022:1018, paras 56-77.

winnings from games of chance organised in other MS are regarded as taxable income, whereas winnings from games of chance organised in the MS concerned are not.[774] The referring court acknowledged that there was a difference in treatment depending on whether the winnings from games of chance were made in Italy or in another MS, but also held that this difference only constituted discrimination if there were no grounds justifying such a difference. Such a difference in treatment could be considered justified if it was covered by an express derogation served to safeguard public order, public security or public health, subject to the principle of proportionality. According to the referring court, Italian law is not so much aimed at protecting national casinos as at discouraging money laundering practices abroad and limiting the flow of capital abroad or the arrival in Italy of capital whose origin cannot be controlled. The referring court decided to stay the proceedings and referred to the ECJ the question whether it is contrary to Arts 52 and 56 TFEU (taking into account Art 62 TFEU) that winnings from games of chance obtained in national casinos are not subject to income tax, whereas winnings from other MS are, and whether reasons of public policy, public security or public health can justify such different treatment.[775]

The ECJ first examined whether there was a restriction on the freedom to provide services. In this context, the Court recalled the Italian rule according to which winnings earned in domestic casinos are subject to a deduction calculated according to the difference between the amounts collected for the games and the amounts paid to players for their winnings, and are exempt from income tax in order to avoid double taxation. In contrast, winnings from casinos located abroad are treated as income and are subject to income tax. Thus, services provided are subject to different tax regimes depending on whether the service is provided in this MS or in another MS, resulting in a discriminatory restriction of Art 56 TFEU for both the service provider and the service recipient.[776] As regards justification, the Court held that discriminatory restrictions are compatible with EU law only if they fall within the scope of an express derogation such as Art 52 TFEU, to which Art 62 TFEU refers and which aims to safeguard public policy, public security and public health. The Court pointed out that it is for the referring national court to determine the objectives pursued by the legislation. However, it noted that Italy had not demonstrated that the proceeds of organised crime, even if high in Italy, were predominantly generated outside Italy. Moreover, the general exclusion of a tax exemption seems disproportionate and goes beyond what is necessary to combat money laundering. Nevertheless,

[774] Cf Case C-42/02 *Lindman* [2003] ECR I-13519.
[775] Case C-344/13 *Blanco and Fabretti* [2014] ECLI:EU:C:2014:2311, paras 9-23.
[776] Case C-344/13 *Blanco and Fabretti* [2014] ECLI:EU:C:2014:2311, paras 25-33.

it cannot be excluded that the fight against gambling addiction falls under the protection of public health. However, taxing winnings from casinos abroad, but not winnings from domestic casinos, is not suitable to ensure the objective of combatting gambling addiction, as such an exemption could encourage consumers to participate in gambling. As a result, the discrimination in question could not be justified.[777]

(d) Violation of both Arts 49 and 56 TFEU: *Commission v Hungary*

The Commission brought an action against Hungary for infringement of EU law concerning the conditions laid down by Hungarian law for the issuing of certain instruments granting a tax advantage enabling workers to benefit from certain accommodation, leisure and food services which constitute benefits in kind provided to those employees by their employer (so-called SZÉP card and Erzsébet vouchers). With regard to the SZÉP card, the Commission considered that food services provided by restaurants and caterers that are not work canteens should be classified as benefits in kind whose conditions of issue are so restrictive that they can only be issued to a limited number of undertakings.[778] As the card scheme was examined in the context of Directive 2006/123/EC, it is not analysed further here. With regard to the Erzsébet vouchers, the Commission considered that public bodies (in particular the Hungarian National Recreation Foundation, HNRF) have a monopoly on the issuance of vouchers for cold and ready-to-eat meals. Moreover, it considered that the issuance of the vouchers could not be regarded as a social measure, since the decision to grant vouchers to employees as benefits in kind was at the discretion of the employer, without pursuing any social objective.[779]

The Court confirmed the economic nature of the issuance and management of the vouchers, as their acceptance resulted in the payment of a consideration to the HNRF. The fact that the law provided that the profits must be used exclusively for public interest objectives does not change the nature and economic character of the activity. Hence, the Court concluded that the issuance of vouchers must be considered a service within the meaning of Art 57 TFEU. In addition, the Court held that a rule which grants a single operator the exclusive right to carry out an economic activity constitutes a restriction of both Arts 49 and 56 TFEU.[780] At the level of justification, the Court reiterated that social policy justifications do not serve as objective justifications when the profits are used to finance social welfare measures. Relying on its case law on betting and gaming, the Court recognised that a restriction such as the granting of a monopoly to a public

[777] Case C-344/13 *Blanco and Fabretti* [2014] ECLI:EU:C:2014:2311, paras 34-48.
[778] Case C-179/14 *Commission v Hungary* [2016] ECLI:EU:C:2016:108, paras 29-33.
[779] Case C-179/14 *Commission v Hungary* [2016] ECLI:EU:C:2016:108, paras 119-140.
[780] Case C-179/14 *Commission v Hungary* [2016] ECLI:EU:C:2016:108, paras 147-164.

body entrusted with the financing of social actions or welfare may be justified, but that this was only the case for a certain number of overriding reasons in the general interest, such as the objectives of consumer protection and the prevention of fraud and the inducement to waste money on gambling, as well as the general need to maintain public order and certain moral, religious or cultural factors associated with betting and gaming. In the present case, however, there were no comparable objectives. Secondly, with regard to the Hungarian government's argument that the monopoly was the only possible means of successfully fulfilling welfare tasks in the absence of available budgetary resources, the Court found that the government had not shown how its establishment served legitimate objectives that could justify restrictions on the freedom of establishment and the freedom to provide services, or how such restrictions complied with the requirement of proportionality. Hence, the issuance of vouchers provided for in Hungarian law infringed both Arts 49 and 56 TFEU.[781]

4.3.3.2. Interim Conclusion on the Freedom to Provide Services

The methodology applied in the context of the free movement of services resembles that applied under the free movement of workers. Hence, the determination of comparability is made, sometimes only implicitly, in the second step of the test when assessing the existence of a restriction. In practice, the Court establishes a difference in treatment by comparing the situations on the basis of which it then finds a restriction or not. Similarly to the free movement of workers, a residence requirement is generally contrary to Art 56 TFEU, unless it is based on specific requirements which for example aim at the application of professional rules in the general interest, which apply to any person in the state concerned. Even if the ECJ does not always explicitly refer to the criterion of comparability, this can always be deduced from the analysis. An example of this is the *TTL* judgement, which involved resident companies having to pay irrecoverable default interest for failure to collect withholding tax on cross-border payments of income to unrelated companies in another MS if they could not prove that the conditions for the application of DTCs were met. In finding a restriction, the Court noted that resident companies were treated differently depending on whether the company receiving the income was resident in Bulgaria or abroad. The Bulgarian government pointed out that the default interest payable only applied to cross-border situations, which supported the Court's finding of comparability and unequal treatment. The Court then examined two justifications and found them to be plausible. However, they failed the proportionality test.[782]

[781] Case C-179/14 *Commission v Hungary* [2016] ECLI:EU:C:2016:108, paras 165-174.
[782] Case C-553/16 *TTL* [2018] ECLI:EU:C:2018:604.

After analysing the case law, it becomes clear that the step with the greater weight is that of justification. Such an approach is appropriate in the area of direct taxation, as it is recognised that not every national measure or provision escapes identification as a restriction, but that MS may have legitimate reasons for doing so within their jurisdiction. For the other freedoms, the examination of the justificatory nature of the measures is not as present and thorough.

Although the justification analysis is relatively detailed, certain measures still fail at the level of proportionality, the assessment of which, in contrast, is not as detailed. Several justifications, such as effective tax collection and the effectiveness of fiscal supervision, are accepted grounds, but may fail at the next stage, e.g. if sanctions (in the form of interest payments) are applied disproportionately and thus negate the justification put forward.

The case law on the freedom to provide services is not so extensive, as it is often considered a secondary freedom, the infringement of which is often invoked together with other freedoms, usually the freedom of establishment.

4.3.4. Art 63 TFEU – Free Movement of Capital

Art 63 TFEU prohibits all restrictions on the movement of capital and payments between MS and between MS and third countries. Examples of prohibited measures are rules that restrict or impede the ability of (foreign) investors to acquire shares or other investments in companies.[783] As economic activities are carried out across borders in the context of the free movement of persons, services, etc, this often includes cross-border capital movements or payments. In this regard, Annex I of the Capital Liberalisation Directive lists a number of covered processes.[784] Similarly to what was stated above in relation to the freedom to provide services, if a measure primarily affects a particular freedom, the Court will limit its examination to that freedom.[785]

Art 65(1)(a) TFEU provides for a derogation of Art 63 TFEU, stating that "[t]he provisions of Article 63 shall be without prejudice to the right of Member States […] to apply the relevant provisions of their tax law which distinguish between taxpayers who are not in the same situation with regard to their place of residence or with regard to the place where their capital is invested". The Court has held on numerous occasions that this derogation must be interpreted narrowly and does not mean that all tax rules and measures that distinguish between taxpayers on the basis of their residence are automatically compatible. In this respect, Art 65(3) TFEU

[783] Case C-282/04 *Commission v Netherlands* [2006] ECR I-9141, para 20.
[784] Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty [1988] OJ L178, Annex I.
[785] Eg Case C-251/98 *Baars* [2000] ECR I-2787.

provides that the national measures and provisions referred to in the first paragraph of Art 65 TFEU "shall not constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital". A distinction is thus made between differences in treatment permitted under Art 65(1) TFEU, which concerns situations that are not objectively comparable or justified by overriding reasons in the public interest, and discrimination prohibited under Art 65(3) TFEU.[786]

4.3.4.1. ECJ Case Law on the Free Movement of Capital

This chapter focuses on the ECJ's most important judgements on the free movement of capital and its interaction with tax measures. The selected cases address critical categories, including capital gains tax, withholding tax, inheritance tax and the taxation of investment funds. The issues raised in these cases reflect some of the most frequently litigated disputes in this area, as evidenced by additional cases cited in the footnotes, which further emphasises their central importance for the Court's reasoning and their impact on national tax systems.

The capital gains tax cases illustrate the challenges that arise when MS tax capital movements, which can inhibit the cross-border flow of investment. The cases on withholding taxes deal with the complexity of source-based tax systems and the need to balance national revenue interests with the principle of equal treatment of foreign investors. These cases are of crucial importance for the delimitation of MS' taxing rights under EU law. Inheritance tax cases show the intersection of tax policy and cross-border asset transfers, where discriminatory or restrictive tax measures applied to foreign heirs or property owners prompted judicial scrutiny under the free movement of capital. Finally, cases involving investment funds highlight regulatory and tax obstacles that may affect the efficient functioning of the internal market for investment products. Hence, this chapter seeks to provide an overview of the evolving case law on the free movement of capital and tax measures and to show trends similar to those seen in the area of the freedom of establishment.

(a) Capital Gains Tax: *Lenz* and *Autoridade Tributária e Aduaneira*

The rather straight forward case *Lenz* concerned the compatibility of Austrian legislation on the taxation of revenue derived from capital with the free movement of capital. Mrs Lenz, a German national subject to tax in Austria, received investment income in the form of dividends from German companies. The Austrian half-rate taxation only applied to capital gains of Austrian origin though.[787]

[786] Eg Case C-181/12 *Welte* [2013] ECLI:EU:C:2013:662, paras 42 and 43 and the case law cited.
[787] Case C-315/02 *Lenz* [2004] ECR I-7063, paras 2-15.

The Court found, first, a restrictive effect of the Austrian legislation on taxpayers, as it discourages Austrian residents from investing in companies established in another MS, and on companies from other MS, as they face an obstacle in raising capital in Austria. It considered this to be a restriction of (now) Art 63 TFEU.[788] It then examined a possible justification and, in this context, carried out an assessment of the comparability of the situations. According to Austria, the provision is intended to mitigate the effects of double taxation of company profits. However, income from both foreign and Austrian capital may be subject to double taxation (corporate income tax and personal income tax). Thus, shareholders liable to tax in Austria with income from capital of an Austrian company or a foreign company are in a comparable situation. Justifications are neither a reduction of tax revenues, the level of taxation of companies resident in other MS, the existence of other tax advantages, effective financial supervision or administrative inconvenience.[789]

In *Autoridade Tributária e Aduaneira*, a person resident in France purchased a building in Portugal and sold it after a few years. This person filed a tax return declaring the transfer of ownership of the building and the expenses and costs of the purchase and sale. In doing so, the applicant had to tick several boxes on his tax return (non-resident, resident in an EU MS, choice of non-resident tax regime). The Portuguese tax authority considered that the uniform non-resident tax rate of 28% applied to the entire positive balance of the capital gain realised on real estate. In contrast, only 50% of capital gains realised by residents on the transfer of real estate located in Portugal were taken into account. The question arose whether a rule making the taxation of capital gains from the transfer of immovable property situated in one MS by a taxpayer resident in another MS conditional on the taxpayer's choice was precluded, so that capital gains of a non-resident were not taxed at a higher rate than those from the same type of transaction by a resident taxpayer.[790]

The Court ruled that when applying the two provisions to residents and non-residents, the tax base for capital gains taxation is not the same. Consequently, non-residents are systematically taxed more heavily than residents on capital gains from the sale of real estate in Portugal and are thus in a less favourable position. The fixing of the tax base at 50% for capital gains realised

[788] Case C-315/02 *Lenz* [2004] ECR I-7063, paras 16-22.
[789] Case C-315/02 *Lenz* [2004] ECR I-7063, paras 23-49; see also Case C-487/08 *Commission v Spain* [2010] ECR I-4843, dealing with the different treatment of dividends distributed to resident and non-resident shareholders; Case C-559/13 *Grünewald* [2015] ECLI:EU:C:2015:109, dealing with the different treatment of income from shares transferred as a gift by way of anticipated succession by resident and non-resident taxpayers.
[790] Case C-388/19 *Autoridade Tributária e Aduaneira (Impôt sur les plus-values immobilières)* [2021] ECLI:EU:C:2021:212, paras 7-19.

by resident taxpayers, but not for non-resident taxpayers who have opted for the non-resident tax-regime, therefore constitutes a restriction on the free movement of capital.[791] As regards comparability, the Court found that there is no objective difference between resident and non-resident taxpayers, since the taxation of capital gains from the transfer of immovable property concerns only one category of income, affects both categories of taxpayer and the MS in which the source of that income is situated is Portugal. The Portuguese government did not put forward any justifying reasons and the Court stated that the requirement to ensure the cohesion of the tax system could not be upheld because the advantage granted to residents outweighs the consideration of the advantage of applying a progressive tax rate.[792] Finally, the Court addressed the option of being taxed under the same rules as residents and held that there is a choice between a discriminatory and a non-discriminatory tax regime. The choice, however, cannot exclude the discriminatory effects of the discriminatory regime. This would have the effect of validating a tax regime that continues to violate Art 63 TFEU, even if its application is optional. The restriction identified was therefore not justifiable in any way.[793]

(b) Withholding Tax: *Sofina* and *Viva Telecom Bulgaria*

For a withholding tax to constitute a relevant restriction of a fundamental freedom, it must disadvantage foreign recipients of passive income compared to domestic recipients. The case law on the comparability of resident and non-resident recipients of passive income has been inconsistent (see *Pensioensfonds Metaal en Techniek* – lack of comparability). However, in recent years the Court has repeatedly ruled that they are indeed comparable for the purposes of withholding tax, since the source State makes them comparable by deciding to tax both on the same item of income (e.g. *AllianzGI Fonds* – comparable situations).[794]

The *Sofina* case concerned the refusal to reimburse the withholding tax levied on dividends. Sofina, Rebelco and Sidro, companies incorporated under Belgian law, received dividends as shareholders of French companies which were subject to a 15% withholding tax under the Franco-Belgian tax convention. Under the French law in question, companies holding shares in a company resident in France are subject to two different tax rules, the application of which depends on whether or not they are resident in that MS. Dividends paid by a French company

[791] Case C-388/19 *Autoridade Tributária e Aduaneira (Impôt sur les plus-values immobilières)* [2021] ECLI:EU:C:2021:212, paras 25-33.

[792] Case C-388/19 *Autoridade Tributária e Aduaneira (Impôt sur les plus-values immobilières)* [2021] ECLI:EU:C:2021:212, paras 34-41.

[793] Case C-388/19 *Autoridade Tributária e Aduaneira (Impôt sur les plus-values immobilières)* [2021] ECLI:EU:C:2021:212, paras 42-47; cf Case C-443/06 *Hollmann* [2007] ECR I-8491.

[794] For more see Ivan Lazarov, 'Case Law Trend: Withholding Taxation Under the Fundamental Freedoms' (2023) 51 Intertax 524.

to non-resident companies are subject to a withholding tax of 25%, which may be reduced under a double taxation agreement, as in the present case (15%). In contrast, dividends paid to a resident company are included in the tax base and subject to corporate income tax, with the possibility of carrying forward losses and offsetting them against the amount of dividends received. As the applicants made losses in the years in question, they applied to the French authorities for a refund of the withholding tax levied on the dividends. Those claims were rejected. The Conseil d'État decided to stay proceedings and to refer the question whether Art 63 TFEU may be interpreted as meaning that the cash-flow disadvantage resulting from the application of the withholding tax to dividends paid to loss-making non-resident companies, whereas loss-making resident companies are not taxed on dividends until the year in which they return to profit, constitutes a difference in treatment, and whether such a restriction is justified by the need to ensure effective collection of tax or the need to safeguard the allocation of taxing powers.[795]

The Court first examined whether there was a restriction on the free movement of capital. Referring to previous judgements,[796] the Court held that the less favourable treatment by a MS of dividends paid to non-resident companies, as compared to the treatment of dividends paid to resident companies, is liable to dissuade companies established in another MS from investing in the first MS and constitutes a restriction of Art 63 TFEU. While dividends paid to a non-resident company are taxed immediately, the taxation of dividends paid to resident companies depends on whether the company's financial year shows a loss or a profit. In the case of losses, taxation is deferred, giving the resident company a cash-flow advantage, and if the resident company ceases trading before it makes a profit, it is not taxed. Furthermore, the Court held that the fact that dividends paid to a non-resident company are subject to a 15% withholding tax in France does not prevent Belgium from taxing those dividends as well. Moreover, unfavourable tax treatment that infringes a fundamental freedom cannot be considered compatible because other advantages may exist. Such an exclusion of a cash-flow advantage in a cross-border situation, when it is granted in an equivalent national situation, constitutes a difference in treatment based on residence and thus a restriction of Art 63 TFEU.[797]

In support of its argument, the French government argued that the situation of resident and non-resident companies was objectively different and that the legislation was justified by the need

[795] Case C-575/17 *Sofina* [2018] ECLI:EU:C:2018:943, paras 1-21 and 25-27.
[796] Especially Joined Cases C-10/14, C-14/14 and C-17/14 *Miljoen* [2015] ECLI:EU:C:2015:608, paras 44ff; Case C-252/14 *Pensioensfonds Metaal en Techniek* [2016] ECLI:EU:C:2016:402, paras 27ff.
[797] Case C-575/17 *Sofina* [2018] ECLI:EU:C:2018:943, paras 23-42.

to ensure the collection of the tax in accordance with the allocation of taxing powers. As regards comparability, the Court held that the situation of resident and non-resident taxpayers becomes comparable as soon as a MS charges both resident and non-resident taxpayers on dividend income received from a resident company. In the present case, the legislation does not limit itself to establishing different rules for the imposition of tax depending on the residence of the recipient of the dividends, but leads to a deferral of the taxation of dividends if a resident company incurs losses, or even to an exemption from taxation if the company ceases trading because it does not regain profitability. Thus, the legislation confers a significant advantage on loss-making resident companies. Such unequal treatment cannot therefore be justified by an objective difference in situation. As for the justification based on the balanced allocation of taxing powers, France would have a right to tax even if the non-resident company were to make profits again in a later year. If this was not the case before the cessation of business activity, such a reduction in tax revenue cannot be considered an overriding reason in the public interest. As regards the justification of effective tax collection, the Court found that the granting of a tax deferral to non-resident companies would not prejudice the achievement of that objective, in particular in view of the mutual assistance mechanisms in place between the authorities of the MS. The reasoning was therefore not accepted.[798]

Another recent case on the issue of withholding tax is *Viva Telecom Bulgaria*, which concerned the taxation of notional interest on an interest-free loan granted to Viva Telecom Bulgaria, a company established in Bulgaria, by its parent company established in another MS. Viva

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[798] Case C-575/17 *Sofina* [2018] ECLI:EU:C:2018:943, paras 43-79; see also Case C-387/11 *Commission v Belgium* [2012] ECLI:EU:C:2012:670, dealing with the Belgian withholding tax for investment companies that make a right to exemption and set-off dependent on their residence; Joined Cases C-10/14, C-14/14 and C-17/14 *Miljoen* [2015] ECLI:EU:C:2015:608, dealing with withholding tax on dividends from the Netherlands distributed to taxpayers resident in Belgium and France; Case C-252/14 *Pensioenfonds Metaal en Techniek* [2016] ECLI:EU:C:2016:402, dealing with the taxation of dividends paid in Sweden by a pension fund established in the Netherlands; Case C-176/15 *Riskin and Timmermans* [2016] ECLI:EU:C:2016:488, in which the Court ruled that Belgian residents who receive dividends from Poland must meet certain conditions for a tax deduction are not in a comparable situation to Belgian residents who receive dividends from a third country with which Belgium has concluded a bilateral convention providing for an unconditional right of set-off; Case C-545/19 *AllianzGI-Fonds AEVN* [2022] ECLI:EU:C:2022:193, in which the Court ruled that Art 63 TFEU precludes legislation under which dividends paid by resident companies to a non-resident collective investment undertaking are subject to tax at source, whereas dividends paid to a resident collective investment undertaking are exempt; Case C-342/20 *Veronsaajien oikeudenvalvontayksikkö (Exonération des fonds d'investissement contractuels)* [2022] ECLI:EU:C:2022:276, on the taxation of rental income and profits from the sale of immovable property in Finland and of shares in companies owning immovable property in Finland held by a French company; Case C-572/20 *ACC Silicones* [2022] ECLI:EU:C:2022:469, in which the Court ruled that a MS may not make the refund of tax on capital gains paid on dividends from shareholdings received by a company in another MS conditional on proof that the tax is neither creditable nor deductible where no such condition is provided for the refund of capital gains tax paid by a resident company; Case C-39/23 *Keva and Others* [2024] ECLI:EU:C:2024:648, on the taxation of dividends received by pension funds governed by public law; Case C-78/22 *XX (Contrats dits unit-linked)* [2024] ECLI:EU:C:2024:932, on the refund of tax on dividends levied in the Netherlands on dividends received by a company established in the UK.

Telecom Bulgaria, as borrower, entered into a loan agreement with its sole shareholder and lender InterV, a Luxembourg company, under which it granted an interest-free convertible loan. The agreement provided that the obligation to repay the loan would lapse at any time after the date of disbursement if the borrower made a contribution in kind to its capital in the amount of the outstanding loan. As the loan was not converted into capital and neither repaid nor bore interest, the tax authorities found tax avoidance and determined that a withholding tax of 10% was payable on the loan. The claim brought by Viva Telecom Bulgaria was dismissed by the Administrative Court on the grounds that the loan was a financial investment that generated a profit due to the non-repayment of interest, while the lender suffered an economic loss. On appeal, the applicant argued that the withholding tax did not take into account that there was a commercial interest in granting an interest-free loan. The Supreme Administrative Court held that under national law there is an irrebuttable presumption of tax avoidance when an interest-free loan is granted, regardless of whether the loan is between related persons or whether this presumption can be rebutted. It also held that, in the case of related parties, economic considerations affecting the interests of the group may justify the conclusion of such a loan. The court hence referred a question on the compatibility of the Bulgarian legislation with Arts 49 and 63 TFEU.[799]

The Court first dealt with the application of the right fundamental freedom. The Court found that the national legislation in question applied to interest-free loans irrespective of the possibility for a company to exercise a certain influence on the decisions of another company (as required for the freedom of establishment) and considered that it fell predominantly within the scope of the free movement of capital.[800] As to the existence of a restriction, the Court held that the rule establishing an irrebuttable presumption of tax avoidance applies in the same way to all interest-free loans, whether or not they involve non-resident companies. Although the same withholding tax rate of 10% applies to resident and non-resident companies, resident companies are taxed on the net amount of their notional interest income after deduction of any expenses associated with the loan, while non-resident companies are subject to withholding tax on the gross amount of their notional interest income without the possibility of deducting such expenses. Although non-resident companies have the possibility to apply for a recalculation of the tax in the following year after payment of the withholding tax, resident companies can deduct these costs directly from the beginning and not at a later stage. This difference in

[799] Case C-257/20 *Viva Telecom Bulgaria* [2022] ECLI:EU:C:2022:125, paras 1-37.
[800] Case C-257/20 *Viva Telecom Bulgaria* [2022] ECLI:EU:C:2022:125, paras 77-84.

treatment gives resident companies an advantage, as it leads to a liquidity advantage over non-resident companies and constitutes a restriction.[801]

In a next step, the Court examined the comparability of the situations and found that the situation of resident and non-resident taxpayers becomes comparable as soon as a MS subjects the income of both to tax. Since Bulgaria has decided to exercise its tax jurisdiction over interest-free loans granted between resident borrowers and non-resident lenders, the situations of the two are comparable.[802] At the justification stage, the Court found that the maintenance of a balanced allocation of taxing powers and the prevention of tax evasion may be relied on as overriding reasons in the public interest and that tax retention at source is a legitimate and appropriate means of ensuring the tax treatment of the income of a taxpayer resident in another MS. The national law at issue thus allows Bulgaria to exercise its tax jurisdiction in respect of activities carried out on its territory by seeking to prevent that the granting of such loans from serving the sole purpose of tax avoidance and can therefore be regarded as appropriate and proportionate to guarantee those objectives.[803]

It is interesting to note that in June 2023, the Commission published a proposal for a Directive on Faster and Safer Relief of Excess Withholding Taxes. The proposal aims to make withholding tax procedures more efficient and secure for investors, financial intermediaries and national authorities in relation to cross-border investments and to help combat tax abuse.[804]

(c) Inheritance Tax: *Welte*, *Commission v Greece* and *XY*

The *Welte* judgment concerned a widower of a Swiss national who died in Switzerland and the assessment of inheritance tax in respect of a plot of land and a house in Germany belonging to the deceased. Mrs Welte-Schenkel, who was born in Germany and took Swiss nationality after her marriage to Mr Welte, a Swiss national, died in Switzerland, where she lived with her husband. As she was the owner of a property in Düsseldorf, the German tax authorities assessed inheritance tax according to cases of inheritance between non-residents and denied Mr Welte the higher allowance in favour of the spouse if the inheritance involved at least one resident. The question therefore arose before the referring court whether, in the case of inheritance of immovable property in that State, where the deceased and the heir were permanent residents of

[801] Case C-257/20 *Viva Telecom Bulgaria* [2022] ECLI:EU:C:2022:125, paras 85-95.
[802] Case C-257/20 *Viva Telecom Bulgaria* [2022] ECLI:EU:C:2022:125, paras 99-108.
[803] Case C-257/20 *Viva Telecom Bulgaria* [2022] ECLI:EU:C:2022:125, paras 109-121.
[804] Commission, 'Proposal for a Council Directive on Faster and Safer Relief of Excess Withholding Taxes' COM(2023) 324 final.

a third country at the time of death, the tax-free allowance was lower than the allowance which would have been applied if at least one of them had been resident in that MS at that time.[805]

The Court first reiterated that, in relation to inheritances, Art 63 TFEU prohibits measures which restrict the free movement of capital and have the effect of reducing the value of the inheritance of a person who is resident in a State other than that in which the property is situated and which taxes it. It therefore concluded that the German rule, which makes the application of a tax-free allowance for immovable property dependent on the residence of the deceased and the heir at the time of death, results in an inheritance between non-residents being subject to a higher tax liability than an inheritance involving at least one resident and has the effect of reducing the value of that inheritance, which constitutes a restriction on the free movement of capital.[806] The German government and the Commission took the view that such restrictions on the movement of capital with a third country may be permissible under Art 64(1) TFEU. According to this provision, Art 63 TFEU applies without prejudice to the application to third countries of restrictions on the movement of capital to or from third countries in connection with direct investment, including real estate, establishment, the provision of financial services or the admission of securities to capital markets. The Court, however, stated that such a provision must be interpreted narrowly and inheritances are not mentioned in the list. The Court further explained that direct investments are investments by natural or legal persons with a view to establishing or maintaining lasting and direct links between the person providing the capital and the company to which that capital is made available for the purpose of carrying out an economic activity. By contrast, investments in immovable property of a pecuniary nature, which are made for private purposes and are not connected with the exercise of an economic activity, do not fall within the scope of Art 64(1) TFEU. Hence, the restriction in question cannot escape the application of Art 63(1) TFEU on the basis of Art 64(1) TFEU.[807]

In a next step, the Court examined the existence of a justification under Art 65(1) and (3) TFEU. As regards the comparability of the situations, the Court held that there was no objective difference justifying the unequal treatment of the situation in which neither person resides in that MS and the situation in which at least one of them resides there. Under German law, the amount of inheritance tax on immovable property is calculated on the basis of its value and the personal relationship between the deceased and the heir, neither of which depends on the residence of the two. The fact that the non-resident heir of a non-resident deceased is only

[805] Case C-181/12 *Welte* [2013] ECLI:EU:C:2013:662, paras 1-17.
[806] Case C-181/12 *Welte* [2013] ECLI:EU:C:2013:662, paras 18-26.
[807] Case C-181/12 *Welte* [2013] ECLI:EU:C:2013:662, paras 27-40.

subject to limited tax liability does not objectively distinguish the situation of this heir from that of the non-resident heir of a resident deceased or the resident heir of a resident or non-resident deceased. Comparability is therefore given in the present case.[808] As a justification, the German government has invoked the principle of tax coherence. For such a justification to be accepted, a direct link must be established between the granting of the advantage and its offsetting. The Court found, however, that the tax advantage resulting from a full tax-free allowance in a case where the inheritance concerns at least one resident is not offset by a specific tax burden resulting from inheritance tax. Moreover, Germany invoked the effectiveness of fiscal supervision and considered that there was no framework for cooperation between the German authorities and the competent authorities of a third country. The Court held that the information relied on by Germany concerned death certificates and similar documents and could in fact be provided by the heirs or the tax authorities of that State in the context of the application of a bilateral double taxation agreement and did not require a complex assessment. In any case, the same inspection of information is also required for the inheritance of a deceased German resident. The German law is thus not justifiable.[809]

Another case concerning the exemption from inheritance tax is *Commission v Greece*. The Commission brought an action against Greece on the grounds that the national law in question infringed Art 63 TFEU. The law provided for an exemption from inheritance tax for primary residents, but excluded this exemption for EU citizens who do not permanently reside in Greece and for nationals of other contracting States to the European Economic Area Agreement, regardless of their residence. According to the Commission, this reduces the value of immovable property acquired by these nationals in Greece through inheritance, as the heirs are subject to higher taxation. Moreover, spouses or children of deceased persons who do not own immovable property are in an objectively comparable situation, whether they are resident or not, since the amount of inheritance tax is calculated on the basis of the value of the property and the family relationship, neither of which depends on residence. Consequently, the provision favours only the heirs who are already resident in Greece, these persons being generally Greek nationals. In response, Greece argued that the situation was not comparable as regards the housing needs of the persons concerned in Greece. The resident heirs have housing needs that can be met or supplemented by the assets received in the succession, whereas the non-resident heirs have a primary residence outside Greece and do not rely on the assets received in the succession and located in Greece to meet their housing needs. However, the Commission

[808] Case C-181/12 *Welte* [2013] ECLI:EU:C:2013:662, paras 41-57.
[809] Case C-181/12 *Welte* [2013] ECLI:EU:C:2013:662, paras 58-68.

considers that the inheritance tax exemption is only a general tax relief which is not justified on housing or social policy grounds, as it is not conditional on the heirs themselves using the assets received by inheritance.[810]

The Court reiterated its judgement in the *Welte* case and held that the application of an exemption from inheritance tax depending on the residence of the deceased or of the beneficiary at the time of death, if it has the effect of subjecting inheritances of non-residents to a higher tax liability than those of residents, constitutes a restriction on the free movement of capital. Indeed, the provision in question has the effect of reducing the value of the estate for the heir who fulfils all the conditions required by Greek law except that of permanent residence in Greece, and hence constitutes a restriction.[811] As regards comparability, the Court agreed with the Commission and found that the situation of an heir permanently resident in Greece and that of a non-resident heir are comparable with regard to the granting of the inheritance tax exemption. At the level of justification, the Court examined the argument put forward by Greece concerning the general social interest in meeting housing needs in Greece. The Court found that this argument was not convincing, as the tax exemption is not conditional on the heir making the inherited property his main residence or inhabiting it at all. In addition, an heir who does not have a permanent residence in Greece at the time of the commencement of the inheritance settlement and who does not own any assets may, just like a resident heir, have a close connection to Greek society and wish to acquire the inherited property for a primary residence there. The reason of preventing a reduction in tax revenue is also not valid.[812]

Eight years after the *Welte* judgment, the Court also ruled in the *XY* case on German inheritance tax on immovable property situated in Germany. The applicant was an Austrian national resident in Austria and sole heir to immovable property in Germany from her deceased father, who was also an Austrian national and resident. The applicant paid her mother and brother the reserved portions and filed her inheritance tax return with the German authorities, who refused to consider the liabilities arising from the reserved portions as debts under succession and only granted a lower allowance than that claimed. Before the court, the applicant argued that she was entitled to the full allowance and that the refusal to grant her a deduction of the value of the liabilities was contrary EU law. The referring court stayed the proceedings and inquired into the compatibility of the national law with Art 63 TFEU, according to which the allowance to

[810] Case C-244/15 *Commission v Greece* [2016] ECLI:EU:C:2016:359, paras 1-24.
[811] Case C-244/15 *Commission v Greece* [2016] ECLI:EU:C:2016:359, paras 25-32.
[812] Case C-244/15 *Commission v Greece* [2016] ECLI:EU:C:2016:359, paras 33-50; cf Case C-670/21 *BA (Successions – Politique sociale de logement dans l'Union)* [2023] ECLI:EU:C:2023:763, on the calculation of inheritance tax on real estate in a third country.

be deducted from the taxable value of the acquisition of immovable property situated in that MS is lower if the deceased and the heir were resident in another MS at the time of death than the allowance that would have been applicable if at least one of them had been resident in the first MS. Moreover, it asked about the compatibility of refusing to deduct the liabilities arising from the reserved portions in the same circumstances, whereas these liabilities would have been fully deductible in the case of residence in Germany.[813]

The Court held that, by providing for a lower allowance on the taxable value than for residents in the case where an estate includes immovable property in Germany and neither the deceased nor the heir is resident there, the legislation subjects non-residents to a higher tax burden which reduces the value of the estate. This constitutes a restriction on the free movement of capital.[814] As regards comparability, the Court noted that the amount of inheritance tax is calculated on the basis of the value of the assets and the personal relationship between the deceased and the heir, without regard to their residence. By equating non-resident heirs who have acquired property from a non-resident deceased and non-resident or resident heirs who acquire such property from a non-resident deceased, the law itself assumes that there is no objective difference between these two situations. The Court concluded that they are objectively comparable situations.[815]

In justification, the German government invoked the cohesion of its tax system and thus a direct link between the tax benefit and its off-setting. The tax-free allowance is intended to ensure the exemption of part of the family's assets by reducing the total amount of the inheritance so that each of the taxpayers can benefit from the inheritance due to the partial tax exemption. The exemption amount can be reduced in proportion to the share of the enrichment in favour of the heir who is not subject to German tax jurisdiction. Hence, there is a direct link between the allowance to which the heir may rely and the extent of the tax jurisdiction over the enrichment derived from the acquisition. Furthermore, the Court considered that this link is appropriate to ensure the attainment of the objective pursued by ensuring that the allowance represents an equivalent share of the part of the estate subject to taxation, irrespective of whether it is subject to unlimited or limited tax liability. It distinguished the case from *Welte* because there the legislation provided for a flat-rate allowance in the case of limited tax liability. By allowing the heir with limited tax liability to claim the full allowance, even though this allowance does not lead to taxation of the entire enrichment resulting from the acquisition by way of inheritance,

[813] Case C-394/20 *XY v Finanzamt V* [2021] ECLI:EU:C:2021:1044, paras 14-25.
[814] Case C-394/20 *XY v Finanzamt V* [2021] ECLI:EU:C:2021:1044, paras 32-34.
[815] Case C-394/20 *XY v Finanzamt V* [2021] ECLI:EU:C:2021:1044, paras 35-44.

this rule prevents the tax capacity of the heir with limited tax liability from being systematically underestimated. Since this legislation is also proportionate, it can justify a restriction of the free movement of capital.[816]

On the other hand, the cohesion of the tax system could not justify the refusal to deduct estate liabilities if neither the deceased nor the heir was resident in Germany, even though these liabilities had a sufficient connection with the components of the overall estate over which Germany exercised its tax jurisdiction and corresponded to a part of the overall estate that did not constitute an enrichment in favour of the heirs with limited tax liability. As regards the argument of the principle of territoriality and the preservation of balanced allocation of taxing powers, Germany has not shown why taking account of the liabilities arising from the reserved portions would lead it to waive part of its jurisdiction. Nor can the MS invoke the possibility of the heir benefiting from similar deductions in another MS, especially if there is not bilateral convention on the taxation of inheritance tax between the States.[817]

(d) Investment Funds: *van Caster* and *L Fund*

Van Caster concerned the assessment of income from non-resident investment funds received by Mrs van Caster and her son, both resident in Germany. The van Casters owned units in non-resident capital investment funds which they had deposited with a Belgian bank. They declared the income from their units by way of an estimate. The German tax authorities assessed the income from the non-transparent funds on a flat-rate basis and calculated the income much higher. The referring court found that while the flat-rate tax mechanism applies equally to non-transparent resident and non-resident investment funds, the provision in question may lead to indirect discrimination against non-resident funds, since resident funds generally meet the information requirements of German law, i.e. the income is subject to either transparent taxation, semi-transparent taxation or, if none of the conditions is met, flat-rate taxation. Hence, it raised the question of whether it is contrary to Art 63 TFEU for the income of a non-resident fund that does not comply with the notification and publication requirements applicable to resident and non-resident funds without distinction to be subject to flat-rate taxation.[818]

The Court noted that the consequences of non-compliance by investment funds are borne by taxpayers who invest in those funds. A flat-rate calculation of income may lead to an overstatement of the taxpayer's actual income and is likely to be detrimental to the taxpayer

[816] Case C-394/20 *XY v Finanzamt V* [2021] ECLI:EU:C:2021:1044, paras 45-55.
[817] Case C-394/20 *XY v Finanzamt V* [2021] ECLI:EU:C:2021:1044, paras 56-76.
[818] Case C-326/12 *van Caster* [2014] ECLI:EU:C:2014:2269, paras 1-24.

who cannot provide supporting documents or information to prove his actual income. The obligations existing under German law are unlikely to be complied with by an investment fund not operating on the German market. As such funds are usually non-resident funds, the legislation in question is likely to deter a German investor from investing in a non-resident investment fund, as the investment may expose such investor to an adverse flat-rate tax without giving him the opportunity to provide evidence or information to demonstrate the actual amount of his income. Hence, the legislation constitutes a restriction on the free movement of capital.[819] Instead of examining the comparability of the situations, the Court went straight to examining possible justifications. As regards the justification of the need to safeguard a balanced allocation of taxing powers, the Court noted that the legislation is aimed at ensuring uniform treatment of investors and not at preventing conduct which might jeopardise Germany's power to tax the activities carried on in its territory or the income earned abroad by its residents. Therefore, the question of the allocation of taxing powers does not arise. As regards the justification of effective fiscal supervision, the Court noted that it is not inconceivable that investors in non-resident funds may be able to provide evidence enabling the authorities to identify the information necessary for a correct assessment of tax. Moreover, the authorities may request information from the authorities of other MS, regardless of whether this would result in a greater administrative burden. In summary, the German law cannot be justified.[820]

L Fund concerned a property fund established as a specialised investment fund under Luxembourg law (L Fund) with only two foreign institutional investors and no central administration or registered office in Germany. Under Luxembourg law, a specialised investment fund is not subject to tax, so that dividends distributed by this fund are not subject to withholding tax and are not taxable at the level of the non-resident investors. Since L Fund generated income from the rental and sale of its real estate in Germany, the German tax authorities considered it to be partially subject to corporate income tax. The referring court found that L Fund, as a specialised property fund, would be liable to corporate income tax on its income from real estate in Germany, while its two non-resident institutional investors would not be liable to tax there. By contrast, a comparable domestic specialised investment fund with two non-residential institutional investors would not be subject to corporate income tax in Germany with this income, as this income would be attributable to the investors. Hence, the court referred the question of whether such a rule, which exempts specialised property funds with foreign investors from income tax, while foreign specialised property funds with foreign

[819] Case C-326/12 *van Caster* [2014] ECLI:EU:C:2014:2269, paras 25-38.
[820] Case C-326/12 *van Caster* [2014] ECLI:EU:C:2014:2269, paras 39-58.

investors are subject to limited income tax on their rental income in that MS, violates Art 63 TFEU.[821]

The Court clearly found a difference in treatment, as resident specialised property funds are exempt from corporate income tax, while non-resident specialised property funds do not benefit from such exemption. This is reinforced by the fact that the German legislation does not make the exemption of these funds conditional on the entire income from real estate being taxed at the level of their investors. Hence, the legislation in question constitutes a restriction on the free movement of capital.[822] In a further step, the Court examined the comparability of the situations. The Court found that the objective of the legislation was to implement the principle of transparency, whereby income is taxed only once, and to ensure equal treatment of direct investment and investment through a fund. By taxing income from real estate held by resident funds only at the investor level, the provisions aim to avoid double taxation. Non-resident specialised property funds with non-resident investors are taxed at the level of the fund and not at the level of investors, as the German legislator cannot guarantee Germany's right, based on the principle of territoriality, to tax these non-resident investors through a withholding tax. Therefore, the distinguishing criterion is the residence of the funds. Moreover, the Court stated that a non-resident fund may also have investors resident in Germany. From this point of view, non-resident funds are in an objectively comparable situation to a resident fund. They are also in a comparable situation with regard to the objective of ensuring equal treatment of direct investment and investment through a fund. Finally, the Court considered that the objective of shifting taxation from the fund to the investors can also be achieved in the case of non-resident funds by making the tax exemption conditional on the taxation of the investors.[823]

To justify this, the German government invoked the preservation of the coherence of the national tax system and the need to maintain a balanced distribution of taxing powers between MS. First, the Court held that, although the exemption is not expressly made conditional in the legislation on the taxation of investors to compensate for that exemption, a link may nevertheless be inferred and would have to be established by the referring court. In any event, the Court found that even if such a link existed, the legislation would not be proportionate, since in the case of resident investors in a non-resident fund, the taxation of the fund results in double taxation (on the fund and on the investor). Hence, the objective of eliminating double taxation cannot always be achieved. A less restrictive measure would be to exempt non-resident funds

[821] Case C-537/20 *L Fund* [2023] ECLI:EU:C:2023:339, paras 13-39.
[822] Case C-537/20 *L Fund* [2023] ECLI:EU:C:2023:339, paras 47-53.
[823] Case C-537/20 *L Fund* [2023] ECLI:EU:C:2023:339, paras 54-65.

from tax, provided that the tax authorities ensure that investors pay a tax equivalent to that which investors in a resident fund have to pay. Second, a MS which chooses not to tax resident funds on their domestic income cannot rely on the need to ensure a balanced allocation of taxing powers. The German legislation is therefore not justifiable.[824]

4.3.4.2. Interim Conclusion on the Free Movement of Capital

Most of the cases judged in the context of the free movement of capital concern withholding taxes and inheritance taxes on immovable property located outside the heir's country of residence. Regarding the choice of tax regimes, the Court reaffirmed its finding that the choice between a discriminatory and a non-discriminatory system cannot offset the discriminatory effects of that regime.

The methodology under the free movement of capital is similar to the freedom of establishment test, where comparability is a separate step between the determination of the restriction and the justification. In this case, however, the Court includes comparability in the justification test. Thus, the Court first examines whether a prohibited restriction exists, i.e. whether a cross-border situation is treated worse than a purely national situation, without formally considering the comparability of the situations. Whether foreign companies are in a different situation to domestic companies is only addressed in the next step. Sometimes this step belongs to the justification step, sometimes it is presented as a separate step in between. This means that any disadvantageous treatment of a cross-border situation is in principle an unlawful restriction of this freedom. A prime example is the *L Fund* case, which concerns a German regulation that exempts specialised real estate funds with foreign investors from income tax, while foreign specialised real estate funds are subject to income tax on rental income. The Court found a difference in treatment by simply stating that resident funds are exempt from tax while non-resident funds are not. The Court then compared the situations in terms of the objective of the legislation and found comparability. The Court did not rule out the possibility of justification, but found that even if the legislation was justified by the reasons put forward by the German

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[824] Case C-537/20 *L Fund* [2023] ECLI:EU:C:2023:339, paras 66-79; see also Case C-386/04 *Centro di Musicologia Walter Stauffer* [2006] ECR I-8203, on the refusal to exempt tax rental income of charitable foundations from corporation tax on the sole ground that the foundation is established in another MS; Case C-190/12 *Emerging Markets Series of DFA Investment Trust Company* [2014] ECLI:EU:C:2014:249, on the refusal to recognise and refund an overpayment of flat-rate corporate tax paid in connection with the taxation of dividends paid by companies registered in Poland to an investment fund registered in the US; Case C-480/19 *Veronsaajien oikeudenvalvontayksikkö (Revenus versés par des OPCVM)* [2021] ECLI:EU:C:2021:334, on the classification of income received by a resident of Finland from an investment fund in the form of a Luxembourg company with variable capital; Case C-18/23 *Dyrektor Krajowej Informacji Skarbowej (Mode de gestion d'un OPC)* [2024] ECLI:EU:C:2024:609, Opinion of AG Kokott, on the difference in treatment between internally and externally managed collective investment funds.

government, it was not proportionate and therefore could not be found compatible with Art 63 TFEU.[825]

As already mentioned in connection with the freedom of establishment, the determination of the existence of a restriction always requires a comparison. Without such a comparison, unequal treatment cannot be proven in the first place, as the initial situation of the case must always be compared with the 'normal' situation. In practice, the Court uses an indirect comparison with the situation of resident companies or taxpayers when assessing the (un)equal treatment of non-resident companies or taxpayers. Sometimes the Court even explicitly mentions the fact that it makes a comparison as a first step by using phrases such as 'as compared to the treatment'.

The methodology in the context of the free movement of capital differs in that aspect that two comparability analyses actually take place: one implicitly in the first step and one explicitly either as a separate step or as an inherent part of the justification assessment. In the latter case, justification becomes a three-step test comprising comparability (i), justification in the strict sense (ii) and proportionality (iii).

4.4. Interim Conclusion on Equal Treatment under the Fundamental Freedoms

It is obvious, as seen in the cases described above, that there are tensions between national tax law and Union law. This is because many of the traditional sources of tax arise from the provision of services, the ownership of capital or income as an employee or self-employed person. This is increasingly associated with a border crossing within the Union and thus with a (potential) encroachment on a fundamental freedom. The Court uses the terms discrimination, restriction, obstacle and impediment interchangeably. The distinction that is usually made between discrimination and restriction, at least in the literature, is not (or no longer) really made by the Court.

In principle, direct taxes remain the responsibility and competence of the MS. The fundamental freedoms merely form an external framework that the MS must observe when organising their tax law. In the case of direct taxes, the ECJ basically only examines whether cross-border situations are unjustifiably treated less favourably than comparable domestic situations as a result of the application of its four-step approach, as assessed in the context of the various fundamental freedoms. First, the Court assesses whether there is a cross-border situation and whether the scope of application is open. Second, it examines whether a cross-border situation is treated less favourably compare than a comparable domestic situation and assesses the

[825] Case C-537/20 *L Fund* [2023] ECLI:EU:C:2023:339.

objective comparability of the situations on the basis of the objective and structure of the tax measure. Third, if there is different treatment, it evaluates whether the measure can be justified by an overriding reason in the public interest. Fourth, it considers whether the measure is proportionate, i.e. it must be suitable for achieving the stated objective and must not go beyond what is necessary. Over the years, the Court has attempted to take account of this competence of the MS and thus also the special features of direct tax law by recognising unwritten grounds of justification. This is a positive development, so that MS, although they must respect the fundamental freedoms, can retain competence for direct taxation and pursue tax policy by demonstrating objective reasons in the general interest. However, the ECJ clearly rejected the MS' argument that direct tax law was excluded from the scope of the fundamental freedoms relatively early on (see *Schumacker* above). Rather, it is now established case law that although direct taxation falls within the competence of the MS, they must exercise their powers in compliance with EU law and, in particular, refrain from any overt or covert discrimination on grounds of nationality. Since the decision in *Avoir Fiscal*, the case law has developed at an incredible pace and the numerous judgements on direct tax law have called into question pillars of the traditional system of cross-border taxation through negative integration. Certain obstacles such as disparities and double taxation remain unresolved by the freedoms or other harmonisation measures. This is due to the interpretation of the scope of the freedoms and probably to the relatively sensitive policy area of direct taxation.

It is clear from the above that the comparability analysis plays an important role in the ECJ's case law on fundamental freedoms and direct taxation. Thus, if the situations examined are not objectively comparable, there is no violation of fundamental freedoms. As a general rule, equal situations must be treated equally and unequal situations unequally. Unequal treatment of non-residents compared to residents is only permissible if the situations are not objectively comparable or if it can be justified by an overriding reason in the general interest. The main practical difficulty in applying the principle of non-discrimination is to establish suitable comparators to determine whether taxpayers are in a similar situation. The key question remains whether the MS extends its power of taxation to cross-border cases (see also Chapter 4.1.1.), i.e. whether both residents and non-residents are liable to tax? Or to what extent are they? If a State decides not to tax the income of non-residents in its MS, the Court cannot order the extension of the power to tax.

The extent to which the objective comparability of the facts and situations is analysed in the decision-making varies greatly. Different or inconsistent importance is attached to the criterion of comparability. In some decisions, the comparability of situations is comprehensively analysed with regard to the objective of the legal regulation under review, while in others its existence is merely confirmed or denied without justification. Sometimes the Court even does not apply the comparability analysis at all.[826] In individual cases, such detailed analyses can hardly be distinguished from the third stage of the non-discrimination test, namely the examination of a justification for the unequal treatment. The question of comparability relates to whether there is discrimination at all. It seems however that it is rather conceived as an intermediate stage, and even as a preliminary justification. The Court's standards of review to date have been characterised by a fluctuating intensity of examination as well as an unclear examination system.

Moreover, it should be noted that the ECJ assumes the existence of a prohibited restriction to varying degrees depending on the fundamental freedom. The result thereof is that the test for establishing discrimination is not only incoherent as regards the individual steps of the test but is also incoherent depending on the fundamental freedom concerned. Under the free movement of workers, for example, the comparability of situations is examined at the first stage when it is assessed whether a restriction or discrimination is present (factual level), whereas under the free movement of capital, comparability is only examined at the third stage (that of justification) which means that any unfavourable treatment is considered a restriction or discrimination and that the burden of proof rests on the MS to show that the situations are not comparable. As mentioned above, in some cases only the overriding fundamental freedom is examined, although several are affected. Therefore, if the result of the examination of the primary fundamental freedom is to be transferable to the others, the fundamental freedoms should generally follow the same examination pattern.

The greatest hurdle for a consistent methodology is the lack of normative anchoring of the non-discrimination test with its different steps and comparators. What can be discerned from the above is that the concept of discrimination or restriction was extended that much in case law that any rule or tax can be found to be restrictive. The fact that the effects of indirect discrimination or the impairment of free movement rights do not have to be proven expose direct taxes to very extensive scrutiny under EU law. Such overstretching of judicial review is the result of this lack of clear normative foundations, especially as the scope and complexity of litigation increases. As in many other areas, for example in relation to technological

[826] This was also recognised in the in Case C-48/13 *Nordea Bank Denmark* [2014] ECLI:EU:C:2014:153, Opinion of AG Kokott, para 25.

developments, the main problem with the adoption of rules is their natural under- or over-coverage, which ultimately leads the courts to gradually extend the scope of these rules. The function of fundamental freedoms will naturally evolve with European integration to police the boundary between legitimate and illegitimate national regulation and extend their scope. The Court not only weighs up the public interest against the right of certain taxpayers, but also assesses national legislation in the non-harmonised area of direct taxation, which leads to interference in the legislative activity of the MS. Ultimately, the Court must strike the delicate balance between the objectives of market integration and the tax sovereignty of the MS, preferably in the context of the proportionality test.

The aim of this chapter was to illustrate the ECJ’s often result-oriented approach to the fundamental freedoms. To put it less negatively: Regardless of which fundamental freedom is affected and what type of tax is involved, the ECJ almost always follows the same approach. The ‘only’ thing that changes is where, i.e. at what stage of the test, comparability is included. Ultimately, the ECJ will have to determine where it belongs in the future. However, the are no different comparator pairs as there are for selectivity under the State aid rules. Perhaps this is because there is no clear indication of the criteria to be taken into account at the comparability or justification stage. It is not certain that the CJEU will decide to apply similar reasoning in cases of tax rulings as in cases of fundamental freedoms. However, alignment, even harmonisation, would be beneficial for legal certainty. On the one hand, selectivity in the context of State aid rules involves a comparability analysis looking for discrimination. On the other hand, the analysis of fundamental freedoms also includes a comparability assessment and similar justification possibilities for infringements as provided for in the State aid rules. The provisions essentially have the same objective and should therefore be equipped with similar, if not identical, tests. The next and final chapter aims to do just that: align and harmonise the tests for establishing unequal treatment under the fundamental freedoms and State aid rules.

5. Bridging the Gap? Trend of Convergence Between Selectivity and Non-Discrimination in State Aid Law and Fundamental Freedoms – The Need for a New Test

The last two chapters on the selectivity criterion under Art 107(1) TFEU and the non-discrimination test in the context of fundamental freedoms have revealed some shortcomings, more in the one, less in the other.

Neither the Commission nor the CJEU have managed to establish a systematic approach or coherent methodology to analysing the selectivity criterion. The first difficulties arise at the first stage of the test: The formation of the reference system is accompanied by different approaches, sometimes it is defined narrowly (exception to the exception), sometimes broadly (income tax per se). Although the tax ruling cases in particular have provided some clarity by explaining that only national law can form the reference system, this does not prevent an artificial system from often being created in order to establish a deviation from it. Moreover, as was discussed previously, this harbours the risk that the Commission and the CJEU will interpret and assess national law. Due to the fact that the measure itself often forms the reference system, a deviation cannot be found in every case. Conversely, the categorisation as prima facie selective of a general regulation that is theoretically open to all companies is not a helpful factor, as almost all national regulations would thus be open to challenge. The comparison pair of recourse to the objective also leaves open whether the objective of the measure or the system is selected. No clear distinction is made here between what falls under the second step and what falls under the third step of the test. The lack of fixed benchmarks renders it impossible to create legal certainty and to design the test in such a way that it can be applied uniformly.

For the fundamental freedoms, a pattern can be recognised, but the test for the individual fundamental freedoms is inconsistent too. The comparability requirement is at the heart of the analysis, but occurs at different stages. While the free movement of workers and the free movement of services consider comparability within the analysis of restrictions, comparability in the freedom of establishment and free movement of capital is a distinct stage that occurs after identifying the restriction but before having regard to possible justifications. This implies that measures will often be categorised as prima facie restrictive before even comparing whether the situations are similar. The justification stage is also examined with varying degrees of intensity for the different freedoms. Particularly in the area of the free movement of capital, comparability is often examined as part of the justification (or, as mentioned, as a separate step). There is no clear delineation between the comparability analysis and the justification analysis. For this reason, the Court has so far handled the examination with varying degrees of rigour, as it is not possible to say with certainty whether comparability is part of the determination of the existence of unequal treatment (or a restriction) or whether it is a separate step or part of the justification.

Taxes are a mass phenomenon, as they affect many individual situations leading to financial burdens. Tax cases therefore require legal certainty not only through national tax regulations, but also through EU law. Most of these cases that were presented in the previous chapters are preliminary rulings, which indicates that there is a significant amount of litigation at national level. Although the European courts cannot intervene at national level, it is precisely in these situations, when answering preliminary ruling questions, that they can provide more clarity with regard to compliance with State aid rules and thus also with internal market rules. Unfortunately, this has not been done to date. The most prominent cases that show that the dialogue so far has not been satisfactory are the transfer pricing cases where tax authorities have relied on domestic transfer pricing regimes developed for group companies in accordance with OECD transfer pricing rules and guidance. Nevertheless, the Commission decided that they should have relied on the general domestic framework rather than the transfer pricing regime. In such individual cases, engagement or dialogue proves particularly difficult.

As it is clear that probably the most effective form of harmonisation is the negative form through the CJEU, a clear and coherent line of case law is very important. In addition to the inconsistencies and ambiguities mentioned earlier, it would be desirable for the CJEU to send a clear signal if previous case law is outdated and is overturned or departed from. However, previous judgments are abandoned as a natural or logical consequence of the development and progress of society and jurisprudence. Moreover, previous judgments are sometimes refined and additional remarks, criteria or explanations are added.[827] A famous example is the issue of the exemption of losses from foreign sources, where the *Lidl Belgium* case has now been overturned and *Marks & Spencer*'s final losses doctrine is no longer relevant for tax treaty exempt cross-border activities.[828] The standard formulas developed by the Court are difficult to set aside, limiting its ability to innovate and preventing a more holistic approach. The GC, which is generally more progressive and endeavours to find innovative ways, is often overruled by the ECJ. The problem with these types of cases is that they take a case-specific approach,

[827] Daniel Sarmiento, 'The 'Overruling Technique' at the Court of Justice of the European Union' (2023) European Journal of Legal Studies 107, 114, 188-119 and 124.

[828] See Case C-538/20 *W (Déductibilité des pertes définitives d'un établissement stable non-résident*) [2022] ECLI:EU:C:2022:717, where the ECJ declared losses from foreign sources incomparable with losses from equivalent domestic activities; see also Alex Cordewener, 'We Need to Know When Previous Case-Law Has Been 'Overruled'! – A Plea for More Legal Certainty in EU Tax Law' (2023) EC Tax Review 144.

meaning that the formulas cannot be applied to all fiscal aids.[829] What is more, in the context of State aid law, certain justifications such as the preservation of tax revenues or ensuring the coherence of the national tax system are acceptable, whereas this is not the case when reviewing discrimination or restrictions of fundamental freedoms, i.e. there is no perfect coincidence.[830] The search for consistency within a legal system is not an easy task and courts try to minimise deviation from precedent by describing such changes as natural or spontaneous developments in case law.[831] The role of CJEU is particularly important to ensure the coherence of the law, but also to guarantee its effectiveness in all MS. Deviating from precedent is necessary and desirable, but should be done in a more transparent way. The difficulty lies in finding a balance between consistency and the necessary change.

It is undisputed that the selectivity test needs to be revised or renewed. For this reason, the present chapter aims to discuss whether this is possible by formally harmonising the selectivity test and the non-discrimination test of the fundamental freedoms and to what extent such convergence may already exist. It has already been explained above that the ECJ in particular is increasingly using the criterion of equal treatment, but that this is not yet included as such in the assessment. What also became clear in the last chapter, however, is that the fundamental freedoms and therefore the non-discrimination test are not applied uniformly. It should therefore be anticipated that a modified test is proposed. The aim is to integrate the best features of the two existing test methods into this new test.

Hence, this chapter examines the increasing convergence between the concepts of selectivity in State aid law and non-discrimination in fundamental freedoms, and critically analyses their similarities and differences, the shortcomings of the current selectivity framework and the potential for adopting a methodology inspired by non-discrimination principles. The chapter concludes by proposing an alternative two-step test and exploring broader reform pathways. The methodology employed is that of a comparative and analytical approach, incorporating the findings of the previously applied case law analysis, critique of the status quo and evaluation of reform proposals.

[829] See also Massimo Merola, 'The Rebus of Selectivity in Fiscal Aid: A Nonconformist View on and Beyond Case Law' (2016) 39(4) World Competition 533.
[830] See also Pierpaolo Rossi-Maccanico, 'Fiscal Aid Review and Cross-Border Tax Distortions' (2012) 40(2) Intertax 92.
[831] Daniel Sarmiento, 'The 'Overruling Technique' at the Court of Justice of the European Union' (2023) European Journal of Legal Studies 107, 107.

5.1. Selectivity in State Aid Law and Non-Discrimination in Fundamental Freedoms – Similarities and Differences

The provisions of State aid law and the fundamental freedoms are both primary law and represent the legal foundations of the internal market and negative harmonisation in the associated areas. As there is no hierarchy or subordination between these regimes, tax measures are inevitably linked to the State and can interfere with the free movement provisions at the same time. Consequently, direct tax measures can be dealt with under both regimes. Moreover, as already explained in Chapter 2, both regimes pursue the same objective of an undistorted internal market that ensures equal treatment of similar situations and market participants.[832] As AG Kokott said, both prohibitions of discrimination, that of State aid on the one hand and that of the fundamental freedoms on the other, serve to complete the internal market.[833] This is also where the similarities between the two regimes lie, namely in their teleology. Despite operating within different legal frameworks, they share several core elements as regards their analysis, in particular involving the determination of equal treatment. Both regimes aim to verify whether comparable situations are treated differently and whether such different treatment can be justified proportionately.

In view of their similarities, from a dynamic perspective, there is a tendency towards convergence in the method of analysis used to scrutinise State measures under these rules. Both sets of rules involve a comparability approach to identify unequal treatment: The fundamental freedoms are concerned with the detection of disadvantages in the form of unfavourable treatment of cross-border situations compared to domestic situations, whereas the State aid rules are aimed at advantages, namely the favourable treatment of selected operators or transactions.[834] The application of the condition of selectivity pursuant to Art 107(1) TFEU and in particular the distinction between general and selective tax measures remains precarious. In this respect, the Court applies a comparison to determine whether undertakings are treated differently and receive a selective advantage even though they are in an objectively comparable situation with others.[835] This approach to selectivity is similar to the non-discrimination test that the Court carries out to establish a violation of the fundamental freedoms, where it is assessed whether cross-border situations are being treated less favourably than domestic ones.

[832] See also Rita Szudoczky, *The sources of EU law and their relationships: Lessons for the field of taxation* (IBFD Doctoral Series 2014) 467-469.
[833] Case C-562/19 P *Commission v Poland* [2020] ECLI:EU:C:2020:834, Opinion of AG Kokott, para 4.
[834] Peter Wattel, 'Forum: Interaction of State Aid, Free Movement, Policy Competition and Abuse Control in Direct Tax Matters' (2013) 5 World Tax Journal 128, 129.
[835] See Case C-143/99 *Adria-Wien Pipeline* [2001] ECR I-8365, para 41.

Both assessments begin by examining whether taxpayers or situations are in similar legal and factual positions. The focus is on whether the situations being compared are objectively similar in light of the objective of the law or tax measure in question. For instance, in both tests, the legal and economic circumstances surrounding the tax measures are analysed to ensure that taxpayers in comparable situations are treated equally.

Both methods of analysis make it possible to justify a prima facie breach of the rules under certain conditions. As far as the fundamental freedoms are concerned, the respective articles themselves provide for certain exceptions. With regard to State aid law, certain measures are automatically deemed compatible under Art 107(2) TFEU, while others can be declared compatible by the Commission under Art 107(3) TFEU. In addition, the CJEU has developed further exceptions to the prohibitions under primary law for both regimes. Accordingly, tax measures that restrict the free movement rights can be justified by overriding requirements in the public interest, such as the need to preserve coherence of a national tax system or to prevent tax avoidance. Tax measures are not considered selective if a differentiation can be justified by the nature and general scheme or structure of the tax system. In contrast to Art 107 TFEU, the free movement provisions explicitly provide for a proportionality test as part of the justification analysis. Nevertheless, the Court has ruled that such a proportionality assessment must also be applied in cases of fiscal State aid.[836] In both frameworks, the justification stage allows for certain discriminatory or selective measures to be deemed lawful, provided that they meet the proportionality criterion. This similarity shows that both legal regimes are not strictly prohibitive, but allow certain exceptions.

Consequently, the present chapter discusses whether certain elements of the assessment of the fundamental freedoms can be transferred to the analysis of State aid and serve as a model. In the case of fundamental freedoms, the comparison is made with the same standard comparators, a cross-border and a domestic situation. In the assessment of State aid, the comparison is less precisely defined as there are no standard comparators. Hence, the assessment of tax measures under the fundamental freedoms is based on a more consolidated methodology that is more conceptually and doctrinally underpinned than the State aid rules.[837] This is also due to the fact that the CJEU case law and the Commission practice constantly adapt and change the State aid

[836] Joined Cases C-78/08 to C-80/08 *Paint Graphos and Others* [2011] ECR I-7611, para 75; Rita Szudoczky, *The sources of EU law and their relationships: Lessons for the field of taxation* (IBFD Doctoral Series 2014) 467-172.
[837] Rita Szudoczky, *The sources of EU law and their relationships: Lessons for the field of taxation* (IBFD Doctoral Series 2014) 467-471.

framework without providing a clear line. Moreover, the Commission only began to subject tax related State aid to more rigorous scrutiny from the 1990s onwards.

Despite these similarities, there are certain differences between these two sets of rules. The most obvious difference lies in their application. State aid law deals exclusively with issues and situations within a MS, i.e. inter-State distinctions. The fundamental freedoms each deal with a cross-border problem, usually involving residents and non-residents or the comparison of domestic and foreign income, i.e. inter-State distinctions. The fundamental freedoms generally involve a disadvantage (negative discrimination), whereas State aid is granted as an advantage (positive discrimination).[838] The question that arises in this context is what the distinction is based on, on the content of the assessment or on the notion of the concept. In State aid law, it makes a difference whether an advantage or a disadvantage is concerned, because this is reflected in two different criteria (economic advantage and selectivity). In the case of the advantage criterion, the existence of an advantage is actually and effectively examined, whereas the selectivity test examines the existence of unequal treatment and thus also a disadvantage for all other comparable companies. However, if one assumes the arbitrariness of the qualification as a rule ('normal' system) or exception (derogation), there is actually no longer any reason to distinguish between advantage and selectivity, since in this case advantage and disadvantage are also arbitrary concepts. The phenomenon of 'selective advantage' is referred to in more detail below. However, if it is a question of the companies concerned being disadvantaged with regard to the fundamental freedoms on the one hand and favoured with regard to State aid law on the other, then this is only a question of consideration. The bottom line is the (non-)existence of unequal treatment, irrespective of whether this consists of an advantage or a disadvantage. As far as the method of determining unequal treatment is concerned, this makes no difference. In any case, any advantage or disadvantage must be compensated.

It is clear from the previous chapters that the methods of analysis and thus the individual steps of the selectivity and non-discrimination tests differ. Although, the finding of comparability and unequal treatment remains at the core, the approach and the standards used are not identical. In State aid law, the comparability assessment is tied closely to the reference system used to define the 'normal' tax regime. Selective treatment is identified by analysing whether a tax measure deviates from this reference system in a way that benefits certain undertakings. In contrast, under the fundamental freedoms, the comparability test is generally broader, focusing

[838] See also Peter Wattel, 'Forum: Interaction of State Aid, Free Movement, Policy Competition and Abuse Control in Direct Tax Matters' (2013) 5 World Tax Journal 128.

on whether cross-border and domestic situations are comparable in light of the objectives of the national measure in question. The non-discrimination test in fundamental freedoms cases adopts a more holistic approach, considering the broader economic context in which cross-border activity takes place. The justification mechanisms also differ: In State aid law, justifications for prima facie selective measures are often tied to the nature or general scheme of the tax system, i.e. the focus is on internal coherence and logic. In contrast, the justifications under fundamental freedoms tend to be broader and can include public policy objectives such as fiscal stability, public security or environmental protection. Additionally, the proportionality test under the fundamental freedoms is generally more developed, requiring that any restriction on free movement must be necessary and proportionate to the objective pursued. In State aid law, while proportionality is still relevant, the focus is more on whether the selective measure distorts competition within the internal market.

Another distinguishing feature is the role played by the Commission. In the case of State aid, it has developed its own methodology over the years, whereas in the case of fundamental freedoms, it is merely the Court that interprets the rules.

The convergence between these two concepts is clear in their methodological reliance on comparability and justification, but they remain distinct due to the different legal contexts in which they operate. Understanding these similarities and differences is crucial for determining whether elements of the non-discrimination test can be adapted to reform and improve the selectivity test in State aid law.

5.2. Overview of the Inconsistencies in Prima Facie Selectivity in State Aid Law

The concept of prima facie selectivity in State aid law refers to the initial determination of whether a tax measure selectively favours certain undertakings. However, as was explored previously, the methodology to determine the selectivity of a fiscal measure follows no clear pattern. In *Gibraltar*, AG Jääskinen rightly remarked in this regard that "[d]espite the copious case-law on this subject, the concept of selectivity is difficult to tie down, in particular with regard to tax measures".[839] The approach available for the assessment of fiscal measures under State aid law includes a derogation and comparability component. For the purpose of clarification, the Commission's Notice of 1998 proposed the derogation approach involving the identification of a reference system, an exception to the latter and the examination of any

[839] Joined Cases C-106/09 P and C-107/09 P *Commission and Spain v Government of Gibraltar and United Kingdom* [2011] ECR I-11113, Opinion of AG Jääskinen, para 176.

possible justification.[840] The Court has never expressly referred to a derogation test in its case law, but rather tends to define selectivity with reference to a comparability approach, as found in *Adria-Wien Pipeline*:

> "[…] The only question to be determined is whether, under a particular statutory scheme, a State measure is such as to favour certain undertakings or the production of certain goods within the meaning of Article [107(1)] of the Treaty in comparison with other undertakings which are in a legal and factual situation that is comparable in the light of the objective pursued by the measure in question."[841]

Hence, the Court requires similar situations to be treated in the same way, making use of the application of the general principle of equal treatment in the context of State aid rules.[842] Since this ruling and as analysed in Chapter 3, the CJEU has followed the comparability approach to tax measures. The Commission has adapted its approach accordingly, which now shows a greater resemblance to the Court's method of analysis.[843] An emphasis is placed on the correct reference system (derogation approach), but at the same time a comparison is employed between the beneficiaries of a measure and those excluded from it. It thereby verifies whether a derogatory measure applies to factually and legally different situations than those covered by the ordinary rule.[844]

In *Forum 187*, AG Léger expressly advocated a reconciliation of the derogation and comparison tests.[845] Thus, the view held was that both tests form part of the selectivity analysis. Again, this is precisely what happened over the last years: The CJEU case law has influenced the Commission's practice resulting in the full incorporation of the comparability approach into recent decisions and investigations. It suggests that the two approaches should be combined.

[840] Commission, 'Notice on the application of the State aid rules to measures relating to direct business taxation' OJ C384/3, 10 December 1998, paras 2 and 16.
[841] Case C-143/99 *Adria-Wien Pipeline* [2001] ECR I-8365, para 41.
[842] Koen Lenaerts, 'State Aid and Direct Taxation' in Heikki Kanninen, Nina Korjus and Allan Rosas (eds), *EU Competition Law in Context, Essays in Honour of Virpi Tiili* (Hart Publishing 2009) 299; Rita Szudoczky, 'Convergence of the Analysis of National Tax Measures under the EU State Aid Rules and the Fundamental Fredoms' (2016) EStAL 357, 360.
[843] See eg *The Reduction of Tax from Intangible Assets* (State Aid No C480/2007 Spain) Commission Decision [2008] paras 14ff; *Groepsrentebox scheme* (State Aid No C4/2007 Netherlands) Commission Decision [2009] para 103; Rita Szudoczky, 'Convergence of the Analysis of National Tax Measures under the EU State Aid Rules and the Fundamental Fredoms' (2016) EStAL 357; Rita Szudoczky and Jan van de Streek, 'Revisiting the Dutch Interest Box under the EU State Aid Rules and the Code of Conduct: When a 'Disparity' Is Selective and Harmful' (2010) 38 Intertax 260.
[844] See also *Tax Amortization of Financial Goodwill for Foreign Shareholding Acquisitions* (State Aid No C45/2007 Spain) Commission Decision [2009] paras 85ff.
[845] Joined Cases C-182/03 and C-217/03 *Belgium and Forum 187 v Commission* [2006] ECR I-5479, Opinion of AG Léger, para 293.

Hence, what can be discerned from the Commission's practice, but above all from the decisions of the CJEU, is that the approaches of derogation and comparability have merged. This means that a measure can only be selective if it deviates from a reference system that leads to different treatment of undertakings that are in a legally and factually similar situation, taking into account the objective of the system. The most prominent cases that have fuelled the debate on the assessment of the selectivity of tax measures are *Paint Graphos* and *Gibraltar*. In *Paint Graphos*, the Court held that selectivity must be analysed by reference to both the identification of a derogation from the ordinary tax system and the comparison of the situations of the undertakings.[846] A few months later, the *Gibraltar* case was decided. The Commission had considered the proposed tax system of Gibraltar as State aid. The GC annulled that decision as the Commission failed to identify and examine the normal regime and a derogation therefrom.[847] On appeal, the AG concurred with the GC and criticised the Commission's innovative approach in using an ad hoc method for the qualification of the system as State aid and for attempting to trigger a methodological revolution under Art 107(1) TFEU.[848] The ECJ having the final say, however, expressed a different view. It found that the system did grant a selective advantage to offshore companies only as it left them untaxed. As a result, it does not depend on the measure constituting a derogation from the normal system in order to be considered selective. The Court thereby relied on its effects-based doctrine.[849]

It can be observed from *Gibraltar* that a pure derogation approach based on the three steps is not suitable for the assessment of all kinds of tax measures resulting in unjustified discrimination. Where the scope of a tax regime as such is queried, it makes more sense to direct the examination to the system as a whole without the need to identify a reference system and its derogation. As a consequence, it seems that the comparability test takes the leading role within the selectivity assessment of fiscal State aid measures. If a differential treatment of objectively comparable situations takes place, this differentiation is a derogation resulting in

[846] Joined Cases C-78/08 to C-80/08 *Paint Graphos and Others* [2011] ECR I-7611, para 49, this is especially reflected in the wording "[…] the measure derogates from that common system inasmuch as it differentiates […]"; Rita Szudoczky, *The sources of EU law and their relationships: Lessons for the field of taxation* (IBFD Doctoral Series 2014) 478-481.

[847] Joined Cases T-211/04 and T-215/04 *Government of Gibraltar and United Kingdom v Commission* [2008] ECR II-3745, para 171.

[848] Joined Cases C-106/09 P and C-107/09 P *Commission v Government of Gibraltar* [2011] ECR I-11113, Opinion of AG Jääskinen, paras 134, 170-171 and 202.

[849] Joined Cases C-106/09 P and C-107/09 P *Commission v Government of Gibraltar* [2011] ECR I-1113, paras 87 and 92.

prima facie selectivity.[850] This is also the reason why some scholars have long been of the opinion that the selectivity test should consist exclusively of the comparability method.[851] The aim of this chapter is to demonstrate and implement this once again. As a preliminary conclusion, it can be said that the methodology applied by the Court depends on the structural characteristics of a measure, i.e. whether such a measure is part of a broader system or whether it constitutes the system itself.

As demonstrated in Chapter 3 and briefly summarised below, the current framework for assessing selectivity in State aid law presents a number of methodological challenges. The derogation approach, which relies on the determination of a reference system, is often subject to ambiguity, making it difficult to establish a clear basis against which tax measures can be assessed. The comparability approach, while essential to establishing any difference in treatment, is complicated by the diversity of economic and legal conditions and not all derogations from the reference system should necessarily be considered selective. Finally, although conceptually sound, the justification and proportionality test suffer from a lack of clarity and consistency in their application, leading to uncertainty among MS regarding the legality of their tax policies. To improve the selectivity test, a reform or reformulation is needed that provides clearer guidelines for the definition of reference systems or rather their complete elimination, a greater emphasis on comparability and a more MS-friendly framework for assessing justifications. Addressing these shortcomings will make the selectivity test more coherent and effective, ensuring that it better aligns with the objectives of State aid control and the need for legal certainty in tax policy.

5.2.1. Step 1 and the Derogation Approach: Determination of a Reference System

The main difficulty arising under the derogation approach is the identification of the reference system, against which an exception or derogation has to be found. The derogation approach depends on what constitutes the 'normal' tax system within which the measure operates. The determination of a reference system is often not straightforward, particularly in complex tax regimes where multiple layers of rules and exceptions exist. The lack of clear guidelines for defining the 'normal' tax framework can lead to inconsistent and subjective assessments,

[850] Joined Cases C-106/09 P and C-107/09 P *Commission v Government of Gibraltar* [2011] ECR I-11113, para 101; see also Rita Szudoczky, *The sources of EU law and their relationships: Lessons for the field of taxation* (IBFD Doctoral Series 2014) 484ff.

[851] See eg Michael Lang, 'State Aid and Taxation: Recent Trends in the Case Law of the ECJ' (2012) EStAL 411, 418; Conor Quigley, 'Direct Taxation and State Aid: Recent Developments Concerning the Notion of Selectivity' (2012) 40 Intertax 112, 113.

leaving room for both the Commission and national authorities to interpret the reference system differently.

It can be difficult to distinguish between general rules and exceptions from the outset. The German *Sanierungsklausel* cases (see Chapter 3.2.1.2.) have shown that the reference system cannot be determined by hooking into a chain of rules and exceptions at the point where the desired result is easiest to achieve. Establishing the general corporate tax as the frame of reference leads to all companies being comparable, which means that favourable treatment is always considered selective. The logical consequence would be to restrict the frame of reference. However, determining the relevant rule for such a narrower framework is an arbitrary task for the Commission or the Court. Moreover, in certain cases it is not necessary to identify a reference system.[852]

An important development in this context is the fact that the ECJ, in particular recently in *Fiat*, has clarified that the Commission's methodology, which is based on a comparison between an existing tax system and another hypothetical system, cannot be upheld. After all, there is no European fiscal comparator or common benchmark, such as a European ALP.[853] The reference system can therefore only consist of national law and can only be that which the MS has established in accordance with its tax sovereignty.

Under the current method, the appropriate determination of the reference framework is crucial for the accuracy of the outcome, as the benchmarks and the subsequent steps are all based on it. The difficult question remains as to which provisions are to be regarded as a general rule in order to justify a deviation from it. Such a derogation must be verified by means of the comparability test. Prima facie selectivity can only exist if the derogation results in different treatment of objectively comparable situations. Hence, the addition of the comparability approach to the derogation test as part of the selectivity assessment is inevitable for the attainment of a reasonable result (if applied consistently).[854] The comparability analysis is directly concerned with whether the measure effects a different treatment of comparable situations, which reflects the substantive economic or legal impact of the measure. This approach shifts the attention from the formalistic and often hypothetical definition of the reference system that can be manipulated or challenged, to the actual effects of a tax measure.

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[852] Joined Cases C-106/09 P and C-107/09 P *Commission and Spain v Government of Gibraltar and United Kingdom* [2011] ECR I-11113.
[853] Joined Cases C-885/19 P and C-898/19 P *Fiat Chrysler Finance Europe v Commission* [2022] ECLI:EU:C:2022:859, paras 81ff.
[854] See also Rita Szudoczky, *The sources of EU law and their relationships: Lessons for the field of taxation* (IBFD Doctoral Series 2014) 515-518.

This is in line with the non-discrimination method under the fundamental freedoms, which does not require such formal identification of a reference system. Aligning the selectivity test with this approach would harmonise the methodologies and reflect the principles underlying both frameworks.

5.2.2. Step 2 and the Comparability Approach: Derogation from the Reference System and the Finding of Unequal Treatment

In the second step, the criterion or benchmark of comparison (*tertium comparationis*) guiding the selectivity or non-discrimination analysis must be determined. This is the heart of the comparability approach. Which criteria should be used to establish a parallelism of situations? In other words, to what extent can two fiscal situations be regarded as alike and thus comparable?[855] Determining comparability can be difficult in practice, as different undertakings may operate under different legal, economic and factual conditions.

The comparability approach implies that a measure is prima facie selective if it derogates from the reference system and if its application leads to a different treatment of objectively comparable situations. The unequal treatment of comparable situations or the equal treatment of different situations is generally associated with the principle or concept of discrimination. As previously explained, the principle of equal treatment or non-discrimination is recognised as a general principle of EU law (also found in Art 18 TFEU). With the adoption of a comparability approach under the State aid analysis, the general principle of non-discrimination is applied to State aid rules.[856] It has already been recognised in several places that the selectivity test is essentially a non-discrimination test and that the concept of selectivity is linked to that of discrimination.[857]

The Court adopted the following wording in *Adria-Wien Pipeline*: "[…] a State measure is such as to favour certain undertakings or the production of certain goods […] in comparison with other undertakings which are in a legal and factual situation that is comparable in the light of

[855] Claire Micheau, 'Tax selectivity in State aid review: a debatable case practice' (2008) EC Tax Review 276, 281.
[856] Koen Lenaerts, 'State Aid and Direct Taxation' in Heikki Kanninen, Nina Korjus and Allan Rosas (eds), *EU Competition Law in Context: Essays in Honour of Virpi Tiili* (Hart Publishing 2009) 299; Michael Lang, 'State Aid and Taxation: Recent Trends in the Case Law of the ECJ' (2012) EStAL 411, 420; Miro Prek and Silvère Lefèvre, 'The Requirement of Selectivity in the Recent Case-Law of the Court of Justice' (2012) EStAL 335, 336; Rita Szudoczky, 'Convergence of the Analysis of National Tax Measures under the EU State Aid Rules and the Fundamental Fredoms' (2016) EStAL 357, 365; Thomas Jaeger, 'Fehlstellungen im Verhältnis von Steuer- und Beihilferecht: Ein Plädoyer für mehr Ausgewogenheit' (2012) EuZW 92, 98.
[857] Case C-562/19 P *Commission v Poland* [2020] ECLI:EU:C:2020:834, Opinion of AG Kokott, para 65; Case C-15/14 P *Commission v MOL* [2015] ECLI:EU:C:2015:32, Opinion of AG Wahl, para 54.

the objective pursued by the measure in question".[858] The test appears to combine all the relevant factors of the comparison carried out in the context of fundamental freedoms: the comparison of the legal and factual situation of the actors involved, taking into account the objective of the measure. Accordingly, comparability in the narrower sense depends on the legal and factual situation in which the undertakings find themselves. However, in order to determine which undertakings are actually comparable, the objective of the measure must be considered. Woefully, the ECJ did not always stick to the objective of the measure in its line of reasoning: In several cases it refers to the "objective pursued by the measure",[859] in other cases it resorts to "objective pursued by the system",[860] "objective pursued by that regime",[861] "objective of the proposed tax reform",[862] or "objective assigned to the tax system".[863] This ambiguity leads to the next problem, namely knowing at which level the respective comparison is to be made, because the objective again plays an important role at the third level. Obviously, the objective of the measure is a much narrower benchmark than the objective of the system.[864] This is also the reason why the objective of the measure should be taken into account in the second step, as it restricts the group of undertakings concerned that are in a similar situation. This could make it more difficult to identify unequal treatment, but this is to be welcomed in order not to regard any measure as a derogation and thus prima facie as selective aid. It should be noted that although the Court has regard to the objective of the measure, this alone does not suffice to exclude it from being categorised as aid, as the effects of a measure must be taken into account in particular.[865] As described above, the Court has ruled that one factor that makes undertakings comparable is whether or not they make use of a particular transaction.[866]

Recent examples of a misconception when defining the reference framework and thus the undertakings to be compared are the tax ruling cases in which multinational companies were

[858] Case C-143/99 *Adria-Wien Pipeline* [2001] ECR I-8365, para 41.
[859] Eg Case C-279/08 P *Commission v Netherlands* [2011] ECR I-7671, para 62.
[860] Eg Case C-308/01 *GIL Insurance and Others* [2004] ECR I-4777, para 68.
[861] Eg Joined Cases C-106/09 P and C-107/09 P *Commission and Spain v Government of Gibraltar and United Kingdom* [2011] ECR I-11113, para 75.
[862] Eg Joined Cases C-106/09 P and C-107/09 P *Commission and Spain v Government of Gibraltar and United Kingdom* [2011] ECR I-11113, para 101.
[863] Eg Joined Cases C-78/08 to C-80/08 *Paint Graphos* [2011] ECR I-7611, para 49.
[864] Cf Miro Prek and Silvère Lefèvre, 'The Requirement of Selectivity in the Recent Case-Law of the Court of Justice' (2012) EStAL 335, 340.
[865] Case C-417/10 *3M Italia* [2012] ECLI:EU:C:2012:184, para 36; Case C-487/06 P *British Aggregates v Commission* [2008] ECR I-10515, paras 84-85; cf Conor Quigley, 'Comments on State Aid, Taxation and Abuse of Law' in Rita de la Feria and Stefan Vogenauer (eds), *Prohibition of Abuse of Law: A New General Principle of EU Law?* (Hart Publishing 2011) 511; cf Michael Honoré, 'Selectivity and Taxation – Reflections in the Light of Case C-487/06 P, British Aggregates Association' (2009) EStAL 527, 534ff.
[866] Case T-219/10 RENV *World Duty Free Group v Commission* [2018] ECLI:EU:C:2018:784, paras 83 and 88; Case T-399/11 RENV *Banco Santander and Santusa v Commission* [2018] ECLI:EU:C:2018:787, paras 84 and 89.

compared with stand-alone companies (see Chapter 3.3.3). It cannot be overlooked that these two categories of companies are in an incomparable situation from the outset. The comparison should only have been made with undertakings that are part of a multinational group. Moreover, in these cases, the focus of the methodology has shifted from a proper determination of prima facie selectivity to the determination of a simple advantage ending in the simple presumption of selectivity. The mere existence of an APA was considered an advantage or rather a derogation. However, these practices are provided for in the respective national laws, which raises the question of which normal system they should be compared with. Tax authorities inevitably have some room for manoeuvre, i.e. more than one result can be at arm's length. Therefore, AG Kokott advocated that State aid should only arise where the method and outcome are manifestly inappropriate and flawed.[867]

It is clear that the Court's methodological attempts at explanation are inadequate due to their lack of consistency, clarity and engagement with the practical realities of tax systems. Furthermore, there is an overlap between steps, insufficient recourse to the non-discrimination method and a lack of systematic guidance. The comparability analysis is frequently used to justify the choice of reference system, creating a circular logic in which the reference system and the comparability analysis are interdependent. It is obvious that a simple derogation from the reference system is no longer sufficient, as this cannot be proven in every case. Instead, a case-by-case comparison of the companies must be made in order to determine whether or not unequal treatment can be established. In some cases, the Court mixes the comparability analysis with the justification phase and treats the assessment of comparability as a preliminary justification. Recourse to the objective as a benchmark should be made at various levels. Firstly, the objective of the measure should be taken into account when assessing the comparability of situations in the second step. Secondly, the objective of the system should come into play at the justification stage when the measure is analysed in the context of the national tax system's logic and nature.

5.2.3. Step 3 and the Justification and Proportionality of Prima Facie Selectivity: By the Nature and General Scheme of the System

After having established the comparability of situations and the resulting unequal treatment, it must be assessed whether the finding of such prima facie selectivity can be justified. As regards the importance of the justification test, including proportionality, the GC summarised this quite

[867] Case C-457/21 P *Commission v Amazon.com and Others* [2023] ECLI:EU:C:2023:466, Opinion of AG Kokott, paras 93-94.

well when it said that individual aid by its very nature introduces a difference in treatment or even discrimination inherent in the individual character of the measure, which is in principle permissible under Art 107 TFEU.[868] In order to escape the classification of State aid, a measure can be justified by the nature and general scheme of the system.[869] Formulations such as "overall structure of the scheme"[870] or "internal logic of the law"[871] are used as synonyms. A measure can be justified by the nature and general scheme of the system if it directly derives "from the intrinsic basic or guiding principles of the reference system or where it is the result of inherent mechanisms necessary for the functioning and effectiveness of the system."[872] Thus, the objective of the system becomes particularly relevant at the justification stage in order to assess whether such a measure follows from the tax system in question or is consonant with it.[873] The justification test is conceptually similar to the justification and proportionality assessments in fundamental freedoms cases, where MS can justify restrictions on free movement if they serve overriding public interests and are proportionate. In the context of State aid law, justifications must be based on the inherent characteristics of the tax system itself, rather than on external policy considerations.

The Commission Notice lists possible justificative reasons and objectives, such as progressivity of a tax (in accordance with the ability to pay), double taxation relief, specific accounting requirements, the fight against fraud or tax evasion or the effective recovery of fiscal debts.[874] Additionally, MS are free to pursue an appropriate economic policy to spread the tax burden as they see fit. Necessary measures following such an economic rationale include the calculation of asset depreciation, tax neutrality for investments in collective investment funds/companies, taxes determined on a fixed basis for specific activities or sectors (e.g. agriculture or fisheries) or the preferential treatment of cooperative societies if all profits are distributed to their

[868] Case T-388/20 *Ryanair v Commission (Finnair I; Covid-19)* [2021] ECLI:C:EU:2021:913, paras 81-82.
[869] See eg Case C-173/73 *Italy v Commission* [1974] ECR 709, para 15.
[870] Case T-233/04 *Netherlands v Commission* [2008] ECR II-591, para 97.
[871] Case C-562/19 P *Commission v Poland* [2020] ECLI:EU:C:2020:834, Opinion of AG Kokott, para 41.
[872] 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' OJ C262, 19 July 2016, para 138, referring to Joined Cases C-78/08 to C-80/09 *Paint Graphos* [2011] ECR I-7611, para 69.
[873] Case C-487/06 P *British Aggregates* [2008] ECR I-10515, para 87; Case T-210/02 RENV *British Aggregates* [2012] ECLI:EU:T:2012:110, para 68; cf Carlo Pinto, *Tax Competition and EU Law, EUCOTAX Series on European Taxation* (Kluwer Law International 2003) 144ff; Pierpaolo Rossi-Maccanico, 'The Point on Selectivity in State Aid Review of Business Tax Measures' in Pasquale Pistone (ed), *Legal Remedies in European Tax Law* (IBFD 2009) 223ff; Rita Szudoczky, *The sources of EU law and their relationships: Lessons for the field of taxation* (IBFD Doctoral Series 2014) 602ff.
[874] 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' OJ C262, 19 July 2016, para 139.

members and tax is levied on these members (double tax relief).[875] Although the Commission Notice and the case law make a distinction between internal and external objectives, it is unclear whether no external reasons apply at all. Some of these objectives have also been reaffirmed by the Court. In *Paint Graphos*, for example, the Court found that cooperatives are not in a comparable legal and factual situation to commercial companies, but even if they were, selective tax exemptions for cooperatives would be justified by the nature and general scheme of the system.[876] As discussed above, in *GIL Insurance*, a higher rate of tax on insurance premiums for insurance sold in connection with the sale or rental of household appliances was justified on the grounds of preventing tax avoidance.[877]

The justification test not only includes justification per se, but also respect for the principle of proportionality, which plays an important role at this stage. This implies that a measure must be necessary, i.e. the least restrictive alternative available and suitable or appropriate for achieving its objective. It must however also be reasonable, i.e. not manifestly inappropriate with regard to the objective. Since the objective of the system somehow creates its own reference framework, the consistency of its application with regard to the reference framework and the matching of the measure to achieve the aim is to be measured.[878] It is important to ensure consistency between the proclaimed objectives and the actual pursuit of the objectives. This is also in line with the Court's effect-based approach.

The problem with the justification level and its non-functioning is that the frame of reference is established as the first step of the investigation, so that unequal treatment is immediately treated as discriminatory. In other words, the Commission seems to have a clear idea at the outset that a particular measure is discriminatory and establishes this outcome from the outset. Moreover, the scope of acceptable justifications is often unclear, and the Commission has broad discretion in determining whether a particular justification is valid. This creates uncertainty for MS, who may be unsure whether their tax measures will withstand scrutiny under State aid rules. Moreover, the justification test does not always adequately address the complex and multi-layered nature of tax systems. Tax measures that appear to be selective in themselves may be part of a broader policy framework aimed at promoting investment, innovation or economic

[875] 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' OJ C262, 19 July 2016, ch 5.4. (specific issues concerning tax measures).
[876] Joined Cases C-78/08 to C-80/09 *Paint Graphos* [2011] ECR I-7611, paras 71-72.
[877] Case C-308/01 *GIL Insurance and Others* [2004] ECR I-4777, paras 74-75; see also Rita Szudoczky, *The sources of EU law and their relationships: Lessons for the field of taxation* (IBFD Doctoral Series 2014) 606-607.
[878] See Joined Cases C-78/08 to C-80/08 *Paint Graphos* [2011] ECR I-7611, paras 73-74; for an appeal to adopt the consistency criterion for State aids, see Ruth Mason, 'Identifying Illegal Subsidies' (2019) 69(2) American University Law Review 479.

growth. In these cases, the justification test should take into account the broader policy objectives underlying the tax system, rather than focusing narrowly on the specific measure at hand. It is also striking that the burden of proof should in principle lie with the Commission. However, this is shifted to the MS by the Commission quickly establishing unequal treatment. This burden should lie primarily with the Commission, even in the third stage, so that the MS only have to refute these arguments in the event of challenge and appeal before the Courts. This would also be in line with the Court's request to ask the Commission to state the reasons for its findings in relation to the selectivity criteria, as consequently stated:

> "It follows from the foregoing that, if the Commission considers, in order to decide to initiate a formal investigation procedure, that a measure is selective, it must state, even in a succinct manner, the reasons why it considers that, within the context of a particular legal regime, that measure has the effect of conferring an advantage on certain undertakings over others which are, in the light of the objective pursued by that regime, in a comparable factual and legal situation."[879]

Justifications are generally handled strictly. However, the nature of tax law allows for a certain tendency to accept justifications; the problem here lies more in proportionality. An important note in this context is the fact that not all aid is State aid. The justification and proportionality tests are important steps in this regard.

5.3. The Potential of the Non-Discrimination Methodology in Fundamental Freedoms for State Aid Law

The principle of non-discrimination in the context of fundamental freedoms, in particular concerning the free movement of workers, services, establishment and capital, provides a well-developed and structured methodology that could be useful for refining the concept of selectivity in State aid law. Non-discrimination in the context of fundamental freedoms is based on two main elements: the comparability test, which determines whether cross-border situations are treated less favourably than domestic ones, and the rule of reason, which allows unequal treatment to be justified on the basis of overriding public interests. These elements offer a clearer and more consistent framework than the selectivity test currently used in State aid law and can provide valuable guidance for improving legal certainty and coherence in the application of State aid rules. The two main steps of the non-discrimination examination, as

[879] Joined Cases C-693/21 P and C-698/21 P *EDP Espana v Naturgy Energy Group and Commission* [2023] ECLI:EU:C:2023:989, para 72.

presented in the next subchapters, and thus the formal division into two examination steps, serve as inspiration for the modified selectivity test that will be proposed later.

5.3.1. The Finding of Equal Treatment: Comparability

The principle of equal treatment and non-discrimination is expressly enshrined in the fundamental freedoms, which prohibit restrictions on the free movement of workers (Art 45 TFEU), the freedom of establishment (Art 49 TFEU), the freedom to provide services (Art 56 TFEU) and the free movement of capital (Art 63 TFEU). These provisions prohibit not only overt discrimination based on nationality, but also any form of covert discrimination. In this context, the ECJ held that unequal treatment or discrimination consists of "[…] the application of different rules to comparable situations or the application of the same rule to different situations".[880]

At the heart of the non-discrimination test in the fundamental freedoms framework is the comparability analysis, which seeks to establish whether two situations are comparable in light of the objectives of the relevant national measure. A comparison is made between a domestic and a cross-border situation, either in a host State or home State scenario. In a host State scenario, the situation of a national or resident of the host State is compared with that of a foreign national or non-resident who has made use of the fundamental freedoms (inbound movement to the host State). In a home State scenario, the situation of a national or resident who exercises their right to free movement (outbound movement) is compared with the situation of another national or resident who has not done so.[881] The Court adopts a broad approach to comparability, taking into account the legal and economic context in which the measure operates, rather than strictly adhering to formal distinctions. This flexible approach allows the Court to ensure that seemingly neutral measures do not unfairly discriminate against cross-border activities.

Hence, the ECJ uses specific criteria to compare these situations in order to establish unequal treatment. The focus is sometimes more and sometimes less strongly on one and the same criterion. For example, in cases concerning the freedom of establishment or the free movement of capital, the Court will examine whether foreign investors or businesses are being treated less favourably than their domestic counterparts. Many of these direct tax cases involve situations in the host State where a non-resident company with a permanent establishment is compared to

[880] Case C-279/93 *Schumacker* [1995] paras 26 and 30.
[881] Rita Szudoczky, 'Convergence of the Analysis of National Tax Measures under the EU State Aid Rules and the Fundamental Fredoms' (2016) EStAL 357, 365.

a resident company. The Court examines the tax treatment or the legal situation of these two companies. If the national legislation places these two types of companies on an equal footing in terms of profit taxation, a difference in treatment through the granting of tax advantages (e.g. tax credits for shareholders) cannot not be justified and would lead to discrimination.[882] The Court's analysis is generally limited to the taxation of a particular type of income that has been denied an advantage (e.g. dividends).[883] The Court previously held that

> "[…] once a Member State […] imposes a charge to income tax not only on resident shareholders but also on non-resident shareholders in respect of dividends which they receive from a resident company, the position of those non-resident shareholders becomes comparable to that of resident shareholders […]".[884]

This finding serves as a transition to the next comparative criterion, which the ECJ frequently applies, particularly in the context of the free movement of workers. Here, the Court rather considers the factual circumstances of the situations in question, e.g. cases of allowances that depend on personal and family circumstances granted to non-residents. As was previously elaborated, non-residents are generally not in a comparable situation to residents in the source State with regard to such allowances. However, if a non-resident receives the majority of his income in a MS other than that of his residence, discrimination arises if neither the State of residence nor the source State takes into account the personal and family circumstances.[885] Although this approach appears open to criticism, particularly in view of the case law in which the Court denied the possibility of justification for MS invoking the existence of tax advantages in other MS and this now playing a role in the non-inclusion of another State, this finding has also prevailed in subsequent cases and other aspects of income tax.[886] In general, the host State cannot deny non-residents the deduction of income-related expenses without discriminating against them.[887]

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[882] Cf Case C-270/83 *Commission v France* [1986] ECR 273, paras 19-20.
[883] Eg Case C-307/97 *Saint-Gobin ZN* [1999] ECR I-6161, Rita Szudoczky, *The sources of EU law and their relationships: Lessons for the field of taxation* (IBFD Doctoral Series 2014) 529ff.
[884] Case C-303/07 *Aberdeen Property Fininvest Alpha* [2009] ECR I-5145, para 43; cf Case C-374/04 *Test Claimants in Class IV of the ACT Group Litigation* [2006] ECR I-11673, para 68; Case C-284/09 *Commission v Germany* [2011] ECR I-9879, paras 55-58.
[885] Eg Case C-279/93 *Schumacker* [1995] ECR I-225, paras 31-38.
[886] See eg Case C-80/94 *Wielockx* [1995] ECR I-2493, paras 20-22 (allocations to pension reserve); Case C-520/04 *Turpeinen* [2006] ECR I-10685, paras 30-31 (retirement pension); C-182/06 *Lakebrink and Peters-Lakebrink* [2007] ECR I-6705, paras 31-35 (losses from immovable property).
[887] Eg Case C-234/01 *Gerritse* [2003] ECR I-5933, para 27 (deduction of business expenses); Rita Szudoczky, *The sources of EU law and their relationships: Lessons for the field of taxation* (IBFD Doctoral Series 2014) 530-532.

Another important criterion for comparability that is closely linked to the legal situation is the objective of the national provision or measure under examination.[888] In both the outbound and inbound scenarios, the Court has established that the comparability of taxpayers must be assessed with regard to the aim of the national legislation.[889]. This tendency is particularly evident in cases of dividend taxation and in cases involving group tax regimes. The objective of group taxation is considered the treatment of a group of companies as an economic unit, enabling the consolidation of profits and losses.[890] The purpose of the group taxation regime serves as benchmark when, for example, resident parent companies with resident subsidiaries are compared with resident parent companies with non-resident subsidiaries to the extent that they seek to benefit from the advantages of the regime, which allows the consolidation of profits and losses of the companies that form a unit and the neutrality of transactions carried out within the group.[891] The legal and factual circumstances are often analysed together with and in relation to the objective of the measure, as they overlap.

Nevertheless, it also happens that the ECJ does not carry out a comparability test at all. In these cases, unequal treatment is simply established per se without a formal comparison being made between the domestic and cross-border situation.[892] A famous example is the case of exit taxation. The Court found a restriction on the freedom of establishment when a tax on unrealised capital gains was imposed on an emigrating taxpayer. It considered this to be unequal treatment compared to taxpayers who maintain their place of residence in the home State, which ultimately discourages taxpayers from relocating their place of residence.[893] According to the Court, exit taxes specifically disadvantage and penalise cross-border movement. The Court has been criticised for its approach: It has not examined whether the taxpayers who emigrated and those who remained were in fact in an objectively comparable situation.[894]

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888 Case C-170/05 *Denkavit Internationaal and Denkavit France* [2006] ECR I-11949, para 37.

889 Eg Case C-107/94 *Asscher* [1996] ECR I-3089, paras 43-48; Case C-319/02 *Manninen* [2004] ECR I-7477, paras 6-17; Case C-253/09 *Commission v Hungary* [2011] ECR I-12391, paras 61-64; Case C-284/09 *Commission v Germany* [2011] ECR I-9879, para 53; 35-36 and 54.

890 Case C-231/05 *Oy AA* [2007] ECR I-6373, paras 35-38; Case C-418/07 *Papillon* [2008] ECR I-8947, paras 27-31.

891 Eg Case C-337/08 *X Holding* [2010] ECR I-1215, para 24; Rita Szudoczky, *The sources of EU law and their relationships: Lessons for the field of taxation* (IBFD Doctoral Series 2014) 536-539.

892 Eg Case C-414/06 *Lidl Belgium* [2008] ECR I-3601, paras 23-26; cf Case C-446/03 *Marks & Spencer* [2005] ECR I-10837, paras 36-40.

893 Case C-9/02 *de Lasteyrie du Saillant* [2004] ECR I-2409, paras 46-48; Case C-470/04 *N* [2006] ECR I-7409, paras 35-39.

894 See in particular Case C-123/11 *A* [2013] ECLI:EU:C:2012:488, Opinion of AG Kokott, paras 40-41; Rita Szudoczky, *The sources of EU law and their relationships: Lessons for the field of taxation* (IBFD Doctoral Series 2014) 539-544.

It is clear from the above that the Court uses different standards for the comparison within the framework of the fundamental freedoms. These essentially include the tax treatment (legal nature) of the cross-border situation, the factual circumstances of the case and the objective of the measure. In the academic literature, different answers are given to the question of what should ultimately be considered the standard comparator.[895] Nevertheless, the Court increasingly refers to the aim or objective of the measure as the key criterion. The assessment of the objective of a measure makes it possible to take into account the factual circumstances and, even more intensively, the tax treatment. However, it should be noted that the aim of a measure can be determined subjectively. In a nutshell, in the second stage, a cross-border situation is compared with a domestic situation. As explained in Chapter 4, case law does not always follow this approach. In several cases concerning the freedom of establishment and the free movement of capital, the Court performed such a comparison at a separate level or at the justification level. For reasons of methodological consistency, it is desirable to make this comparison at the second stage.

5.3.2. Rule of Reason under the Fundamental Freedoms: Justification

A discrimination or restriction of the fundamental freedoms can be justified by the rule of reason, unless justification is expressly provided for in the TFEU. The rule of reason operates as a balancing mechanism and implies that for reasons of public interest, a discriminatory or restrictive national measure may be justified if it pursues a legitimate objective and is a proportionate means to attain such an objective. The rule of reason was first articulated in the landmark case *Cassis de Dijon*[896] concerning the free movement of goods and was later extended to all free movement provisions.[897] Thus, a measure must fulfil three conditions: there must be a legitimate objective (1), which is explained by an imperative reason in the public interest (2) and which passes the proportionality requirement (3). The function of the rule of reason is to find a balance between an extensive interpretation of the freedoms and national tax sovereignty.[898]

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[895] See eg Philip Laroma Jezzi, 'The Concept of "Comparability" in the Direct-Taxation-Jurisprudence of the European Court of Justice' (2010) 10 EC Tax Journal 89, 141 ('purpose of the national provision'); Michael Lang, 'Recent Case Law of the ECJ in Direct Taxation: Trends, Tensions, and Contradictions' (2009) EC Tax Review 98, 101-113 ('legal situation'); Joachim Englisch, 'Taxation of Cross-Border Dividends and EC Fundamental Freedoms' (2010) 38 Intertax 197, 203-204 and 212 (disagrees with all criteria, proposes alternative criterion 'internal market objective'); Rita Szudoczky, *The sources of EU law and their relationships: Lessons for the field of taxation* (IBFD Doctoral Series 2014) 544ff.

[896] Case C-120/78 *Rewe v Bundesmonopolverwaltung für Branntwein* [1979] ECR 649, para 8.

[897] Case C-55/94 *Gebhard* [1995] ECR I-4165, para 37; for cases concerning fiscal measures, the Court makes use of a standard formulation as found in Case C-446/03 *Marks & Spencer* [2005] ECR I-10837, para 35.

[898] Joachim Englisch, 'Tax Coordination between Member States in the EU – Role of the ECJ' in Michael Lang and others(eds), *Horizontal Tax Coordination* (IBFD 2012) 16.

The fundamental freedoms analysis accepts the justification grounds of the cohesion of the system, the preservation of the balanced allocation of taxing rights, the effectiveness of fiscal supervision and the prevention of tax evasion. These objectives are all inherent or internal to a particular tax system and its operation and are similar to the State aid's nature and general structure of the system and the distinction made there between internal and external justifications.[899] External reasons are not accepted, such as objectives of an economic or financial nature.[900] A frequent justification attempt put forward by the MS is the view that a higher tax burden is justified because the person or company concerned enjoys other tax advantages in the discriminating MS or in another MS. The Court has repeatedly rejected this argument, as such an additional tax burden would deter or even prevent a person from doing cross-border business or relocating.[901] Although the rule of reason suggests that the assessment in the context of the fundamental freedoms is more open to different justification grounds and more possibilities for States to defend their policy choices, it also distinguishes between the two categories of internal and external justifications.

Moreover, as already noted in Chapter 4, the comparability assessment is sometimes shifted to the justification stage. This applies in particular to the free movement of capital, where the incomparability of situations is used as a justification instead of denying the existence of a restriction from the outset. This analysis should be shifted back to the level of identification of discrimination/restriction or to the additional step between this identification and justification, as is the case with the freedom of establishment.

In addition, the proportionality test under the rule of reason provides a structured approach to assessing whether a measure goes beyond what is necessary to achieve its objective. This helps to prevent overly broad or excessive tax measures from being justified, while still allowing for legitimate policy differences between MS. As in the area of State aid law, there are similar considerations regarding the consistency of the justification, or rather proportionality (as part of necessity), of restrictions on fundamental freedoms.[902] The standard formula chosen by the Court is "that national legislation is appropriate for ensuring attainment of the objective pursued

[899] Rita Szudoczky, *The sources of EU law and their relationships: Lessons for the field of taxation* (IBFD Doctoral Series 2014) 613ff.
[900] Eg Case C-35/98 *Verkooijen* [2000] ECR I-4071, para 48; note that the promotion of research and development is usually an exception.
[901] See eg Case C-330/91 *Commerzbank* [1993] ECR I-4017, paras 16ff; C-307/97 *Saint-Gobin ZN* [1999] ECR I-6161, paras 51ff; Case C-141/99 *AMID* [2000] ECR I-11619, para 27.
[902] Eg Case C-169/08 *Presidente del Consiglio die Ministri* [2009] ECR I-10821, para 42; for more see Werner Haslehner, '"Consistency" and Fundamental Freedoms: The Case of Direct Taxation' (2013) 50 CMLR 737.

only if it genuinely reflects a concern to attain it in a consistent and systematic manner".[903] Accordingly, taxing rights must be exercised in a consistent manner. The consistency requirement is generally impractical as it requires a complete overview of a MS' tax system.

5.4. Preliminary Concluding Remarks on the Trend of Convergence

In order to create a coherent, comprehensive fiscal State aid framework under Art 107(1) TFEU, the comparability test is the most important instrument for the assessment. It should, however, not be neglected that the assessment usually involves a derogation in combination with the comparability test. As was established in the previous chapters, a pure derogation approach is not suitable for determining selectivity. Instead, it only works in combination with a comparability assessment, which requires equal treatment of operators or situations. The first step of the test, the identification of the reference system, can be helpful in more complex situations. Nevertheless, whenever a measure is self-sufficient, i.e. it constitutes a system of its own, the derogation test tends to become superfluous. It has been emphasised that only national law can form the reference system. Determining or evaluating the reference system in this way becomes a difficult task for the Commission and Courts. Furthermore, the rules identified as normal taxation and the derogation therefrom may consist of different provisions with different legal consequences and application scopes. The second step of the test aims at a formal derogation from this reference system by establishing a different treatment of objectively comparable situations. The implicit notion of equal treatment can be linked to the principle of non-discrimination. The second step is very similar to the non-discrimination test in the context of fundamental freedoms, as all the elements are also found here, i.e. the comparison of the legal and factual situation and the consideration of the objective of the measure. The third step of the test, which involves the possibility of justifying prima facie selectivity by the nature and general scheme of the system, is based on internal reasons arising from the effective functioning of a system. Therefore, the objective of the system is very relevant at this stage. Moreover, tax measures must fulfil the requirement of proportionality, including considerations of consistency, so that the proclaimed objectives and the objectives actually pursued coincide. To summarise, the comparability test in the selectivity analysis tends to be rather strict. The focus is on whether a tax measure deviates from a predefined reference system and whether that deviation results in selective benefits for certain undertakings. This approach can be overly technical and lead to inconsistent outcomes.

[903] Eg Case C-169/07 *Hartlauer* [2009] ECR I-1721, para 55 (which was however not on tax law).

As far as fundamental freedoms are concerned, a non-discrimination test is carried out to determine unequal treatment by means of a comparability assessment between domestic and cross-border situations. The legal situation of companies or taxpayers is taken into account, whereby the examination is limited to a specific type of income. This usually also involves an examination of the objective of the measure and the factual circumstances of the situations. However, this comparability assessment is carried out at different stages of the test depending on the freedom concerned. It is also possible that it is not carried out at all, whereby unequal treatment is merely established without a formal comparison being made. The justification analysis is carried out with reference to the objectives expressly recognised in the Treaty or the rule of reason, including the objectives inherent in the system. The selectivity test in State aid law contains a similar justification mechanism. However, this justification framework is often narrower than the rule of reason. In State aid cases, justifications must be closely linked to the internal logic of the tax system, which limits the scope for policy justifications that address broader public interests and does not adequately take into account legitimate policy objectives that MS may wish to pursue. It also emphasises the importance or proportionality and consistency of tax measures more than Art 107(1) TFEU. The rule of reason, with its broader scope for justification and its emphasis on proportionality, could offer a more flexible and comprehensive justification framework for the selectivity test.

A comparison of the Court's approach in the context of the fundamental freedoms and State aid rules reveals a convergence. The concepts are very close to each other, as the Court bases both sets of rules on a comparability approach, which is an expression of equal treatment. Under the State aid rules, the basis for comparison consists of the factual and legal circumstances in the light of the objective of the measure in question. This means that the assessment of selectivity of fiscal State aid is directly linked to the discrimination analysis within the framework of the fundamental freedoms. Under the fundamental freedom rules, the Court compares a cross-border situation with a domestic situation, taking into consideration the same factors. Both sets of rules target the difference in treatment of objectively comparable situations, while having regard to the objective of the measure. Moreover, this comparison takes place at different levels of analysis in both cases. The justification stage also converges in its methodology, as both only accept system-internal objectives and require that the measures are proportionate and consistent. The inner logic justification in State aid is in essence that of the coherence of the tax system under the fundamental freedoms.

The methodology of non-discrimination in the context of fundamental freedoms offers several important insights for improving the selectivity test in State aid law. The comparability test under the fundamental freedoms, with its broader and more context-sensitive approach, could help refine the determination of selective advantages by focusing on the actual economic and legal comparability of undertakings. This would ensure greater flexibility and consistency and avoid an overly rigid application of the selectivity test in its current form. Similarly, the rule of reason, with its broader justification framework and its focus on proportionality, could improve the justification framework for selective measures in State aid law. By taking into account legitimate policy justifications, provided that they are proportionate, the rule of reason could offer a more balanced and flexible approach to the selectivity test, while maintaining the integrity of the internal market. Ultimately, integrating elements of the non-discrimination methodology into the selectivity test could lead to a more coherent and predictable legal framework for the assessment of fiscal State aid. Such an approach would better reflect the complex realities of modern tax systems and provide more legal certainty for MS and businesses alike.

The aim of this research is to find out to what extent the selectivity test can be improved using the example of the non-discrimination test in the context of fundamental freedoms. It can already be said that the two concepts essentially overlap and converge. However, it should also be noted that the non-discrimination test of the fundamental freedoms also has conceptual problems and should therefore not be adopted one-to-one. For this reason, the next step will be to discuss the extent to which the selectivity test, still oriented towards the non-discrimination test, needs to be reorganised or redesigned in order to create a uniform standard.

5.5. Redefining Selectivity: Alternative Two-Step Test

The concept of selectivity in State aid law, while crucial for maintaining fair competition within the internal market, has become overly complicated and inconsistent in its current form. The three-step test, which involves defining a reference system, identifying a derogation from that system and analysing whether the measure can be justified, often leads to ambiguity, particularly in complex tax systems.

In recent years, the concept of equal treatment and non-discrimination has been repeatedly mentioned in connection with the fiscal State aids, as it is already known from the fundamental freedoms. Interestingly, the notion of unequal treatment appears in the Commission Notice 2016, which states that Art 107(1) TFEU "(…) prohibits unequal treatment in taxation of undertakings in a similar factual and legal situation."[904] However, this must be read against the background that the entire section of the Notice is flawed, as it concerns the section on tax rulings and the ALP, in which the Commission wrongly assumed that such an autonomous European principle arises from Art 107 TFEU. Nevertheless, the principle of equal treatment has formally found its way into the Notice and should remain. Moreover, the notion of non-discrimination appears in the Guidelines on State aid for climate, environmental protection and energy 2022.[905] Hence, equal treatment and non-discrimination are already somehow incorporated into State aid law, even if they are not formally recognised or expressed as elements of Art 107 TFEU.

Moreover, case law is also increasingly referring to non-discrimination language, e.g. when stating that the regime in question "in practice discriminates between companies which are in a comparable situation"[906] or that the different treatment suffered by certain undertakings in comparable factual and legal situations "can, in essence, be classified as discriminatory".[907] A similar tendency can be observed among the opinions of AGs. AG Wahl expressly said that MS may not act in a discriminatory manner and that "the concept of selectivity is linked to that of discrimination".[908] Probably the most apt statement in this context comes from AG Bobek when he describes that the

> "heart [of selectivity] reminds one of a Russian doll: only by opening the external layer does one see that the key notion is in fact that of discrimination. And again, hidden further within the notion of discrimination is comparability. Thus, when searching for the genuine content of selectivity, one arrives at the notion intimately known from other areas of EU law: comparability."[909]

In this sense, the selectivity test should apply a non-discrimination standard, as also applies under the fundamental freedoms. Accordingly, the three-step test should be brought back to a two-step selectivity test based on the following questions: (1) Do the rules in question discriminate between comparable undertakings as determined by the objective of the measure?

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[904] 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' OJ C262, 19 July 2016, para 172 (section 5.4.4.1. administrative tax rulings).
[905] Commission, 'Guidelines on State aid for climate, environmental protection and energy 2022' (Communication) OJ C80, 18 February 2022, para 3.1.2. (31a) on incentive effect: (…) the aid is granted (…) in accordance with objective and non-discriminatory criteria (…).
[906] Case C-106/09 P *Commission and Spain v Government of Gibraltar and United Kingdom* [2011] ECR I-11113, para 101.
[907] Joined Cases C-451/21 P and C-454/21 P *Luxembourg v Commission* [2023] ECLI:EU:C:2023:948, para 106.
[908] Case C-15/14 P *Commission v MOL* [2015] ECLI:EU:C:2015:32, Opinion of AG Wahl, para 54; cf Case C-66/14 *Finanzamt Linz* [2015] ECLI:EU:C:2015:242, Opinion of AG Kokott, para 82.
[909] Case C-270/15 P *Belgium v Commission* [2016] ECLI:EU:C:2016:289, Opinion of AG Bobek, para 29.

In other words, is a selective measure present? (2) Is that discrimination justified by the nature and logic of system and proportional?

It is therefore not necessary to define the reference system in order to apply the comparability approach. It is sufficient if the objective of the measure (and not the system) is used as a benchmark, as was done in *Adria-Wien Pipeline* and *Paint Graphos*. This would also ensure a clearer separation of the State aid conditions of selectivity and advantage. Moreover, such an approach would be simple, as it is easier to determine the coherent (or non-coherent) objective of a measure than the objective of a set of rules that are unlikely to have been adopted simultaneously and harmoniously, defining a hypothetical reference framework.[910] In this case, the Commission should be able to justify and explain why it considers a particular objective to be inadmissible. The MS would thus regain their room for manoeuvre, but at the same time would have to base any difference in treatment on legitimate objectives. This chapter therefore proposes an alternative, streamlined two-step test for assessing selectivity, focusing on comparability as a first step and on justification and proportionality as a second. This redefinition aims to bring more clarity and coherence to the assessment of State aid and to align the process more closely with the principle of non-discrimination as applied in the fundamental freedoms.

5.5.1. First Step: Comparability

Depending on how the reference system under the ordinary three-step test is formed, the result of the selectivity assessment may vary. As this is a very uncertain factor, it would be better to avoid this step altogether. Moreover, in certain cases, derogations from such a reference system cannot be established as the system as such will be considered selective (see *Gibraltar*). Rather, the emphasis should be on the finding of a material discrimination and not simply formal exceptions or derogations from the reference system. In *ANGED*, AG Kokott again emphasised that the determination of the normal system cannot be decisive, but that only the examination of unequal treatment with regard to the objective pursued by the law is decisive.[911]

Hence, the first step of the two-step test should consist of the comparability stage, where companies in similar legal and factual situations are compared by means of the objective of the measure. This then very much resembles the comparability standard under the fundamental freedoms, where companies subjected to the same rules, i.e. legal treatment, and finding

[910] Cf Nicolás Martínez Pérez-Mendana, 'Sélectivité en matière fiscale: une analyse généalogique de la méthode en trois étapes' (2019) 55(2-3) Cahiers de droit européen 485.
[911] Case C-236/16 *ANGED* [2017] ECLI:EU:C:2017:854, Opinion of AG Kokott, para 88.

themselves in similar factual circumstances are compared. By focussing on this actual comparison, the need to create an artificial reference framework is avoided. Thus, this comparison exercise must be understood in a broad sense, so that the reason for (non-)taxation of a certain (category of) undertaking is irrelevant, be it a derogation or exemption from the general system. Thereby, not only the undertakings falling within the formal definition of a tax measure are captured, but all those in a comparable situation, bringing the assessment in line with the Court's effects-based approach. Before, the scope of the relevant measure must of course be established, i.e. which undertakings are covered and are to be covered. This however inherently forms part of the comparability approach when the legal situation of the undertakings is assessed.

The examination at this stage should be carried out with regard to the objective of the measure. The reason for this is that the objective of the system will be taken into account later at the level of justification. Although the Court has ruled in some isolated cases that the objective of the system must be taken into account at the second stage (that of derogation or comparability), this is not a common practice and it is more logical to postpone its consideration to the last stage.[912] This currently also applies to the non-discrimination test in the context of fundamental freedoms, where the objective of the measure is used in the formal second step (identification of unequal treatment or discrimination).

Regarding the particular case of tax rulings, the GC made a strong point, when it held that differential treatment is only relevant under State aid law if the differentiations are more than simple inaccuracies that may occur with transfer pricing practices.[913] Determining the taxable profit is not an exact science. The transfer pricing methods only allow an approximation. The ALP plays an important role for the question of compatibility of tax rulings with State aid law. However, as was clarified by the Court, it is not a European principle, but rather a tool for the Commission to compare the taxation of different undertakings. This is however subject to the proviso that the ALP is part of national law.[914] This should be borne in mind when comparing undertakings and their situation under the first step in evaluating the existence of unequal treatment.

[912] See eg Joined Cases C-53/19 P and C-65/19 P *Banco Santander and Santusa v Commission* [2021] ECLI:EU:C:2021:795, para 125; see also Andreas Bartosch, 'Spanish Goodwill – A Textbook on Material Selectivity Awaiting a Second Edition' (2022) EStAL 65.

[913] Joined Cases T-755/15 and T-759/15 *Luxembourg v Commission* [2019] ECLI:EU:T:2019:670, para 144.

[914] Cf Benedikt Freund and Moritz Seiler, 'Beihilfenrechtliche Stolpersteine für Steuervorbescheide: eine Wegleitung entlang der Rechtsprechung des EuG' (2021) EuZW 673.

The tax ruling cases are a good example of how this comparability test could work in practice. In many of these cases, e.g. *Starbucks*, the Commission argued that national tax authorities had granted selective tax advantages to the undertakings concerned by approving a transfer pricing arrangement that allegedly deviated from the ALP. Under the traditional three-step test, the analysis focused heavily on whether the undertakings received an advantage that deviated from the 'normal' tax system, leading to a complicated examination of the reference system and transfer pricing rules. Under the two-step comparability-based test, the first question would simply be: Are the undertaking in question and other companies operating in that MS in a comparable position? The answer would be yes, they are all subject to the same transfer pricing rules and should be treated equally. The analysis would then focus on whether the specific tax ruling granted led to a difference in treatment of comparable companies subject to the same transfer pricing rules. If the tax ruling conferred an advantage that other comparable companies did not receive, prima facie selectivity would be established.

Summarising, the guiding questions at the first stage are as follows: Does the measure apply to all undertakings (i.e. scope) that are in a comparable legal and factual situation (i.e. comparability)? Do certain undertakings enjoy more favourable treatment (i.e. prima facie selectivity)?[915] The comparability analysis is undoubtedly the core of the entire assessment. It can be seen as the gatekeeper of selectivity, determining whether a measure treats similar situations equally and whether prima facie selectivity can therefore be justified. Without a solid comparability analysis, the entire test degenerates into a superficial exercise, as happens now, whereby measures are labelled selective purely on the basis of their formal deviation from a broader system, without proper consideration of the substantive policy objectives or the factual context.

In the next step, it will then be assessed whether the measure can be justified by the nature or structure of the tax regime and whether it fulfils the proportionality requirement.

5.5.2. Second Step: Justification and Proportionality

Once comparability has been established and unequal treatment identified, the next step is to assess whether this unequal treatment can be justified and whether the measure is proportionate to its intended objectives. The second step of the two-step test should therefore consist of the justification level, taking into account the objective of the tax system. An approach based on an adjusted rule of reason, similar to that under the fundamental freedoms, would be conceivable

[915] Cf Case C-106/09 P *Commission and Spain v Government of Gibraltar and United Kingdom* [2011] ECR I-11113, Opinion of AG Jääskinen, paras 185-187.

for the justification of prima facie selective measures. In practice, the following two conditions would have to be fulfilled: (1) the objective of the system must be legitimate and (2) the measure must be proportionate, i.e. suitable and necessary to achieve the desired objective and impose no excessive burden. This would allow different policy objectives to be taken into account.

Accordingly, justification should be possible if the difference in treatment is consistent with the internal logic and objectives of the tax system. An adjusted rule of reason, inspired by the justification stage in the non-discrimination analysis under the fundamental freedoms, would allow MS to demonstrate that prima facie selectivity serves a legitimate policy goal inherent to the tax system itself, provided that it meets the proportionality requirement. MS would be able to justify restrictions with compelling reasons of public interest, such as fiscal coherence or combating tax evasion. The general framework of such a rule of reason would be to demonstrate the legitimate objectives behind a tax measure and its proportionality. One example of its application is tax incentives for research and development, which favour certain industries but can be justified by the need to promote innovation and economic growth. Proportionality would require that the incentives be targeted and not too broad. The introduction of this approach would make the selectivity test more balanced, flexible and purpose-driven, increasing the legal certainty and legitimacy of tax measures that pursue genuine fiscal objectives.

Thus, as for the fundamental freedoms, the objective of the system (and not of the measure) should play a role in the second step. A difference in treatment may be justified if it pursues an objective that is inherent in the tax system, such as ensuring tax collection, achieving fair redistribution (e.g. through progressive taxation), promoting innovation or investment (e.g. for green energy or research and development), facilitating corporate restructuring, supporting structural policies (e.g. employment or regional development) or ensuring efficient administration. For example, loss carry-forward rules that allow only companies in severe financial difficulties to offset losses might be justified as promoting business continuity. In contrast to the status quo, however, no formal distinction should be made between internal and external objectives. Even if, for example, economic or financial policy objectives would be accepted in such a scenario, they must in any case pass the proportionality test. Ultimately, this would not introduce such a big difference to the current reference to the nature and general scheme of a system, but would avoid the confusion of what to label as internal and external.

To further refine the justification, the measure must comply with the principle of proportionality, which has two main components. On the one hand, the measure must be suitable and thus appropriate to achieve the identified objective. On the other hand, the unequal treatment must not go beyond what is necessary to achieve the objective of the tax system. For instance, granting special tax relief only to certain sectors could be justified during a crisis if these sectors are objectively more vulnerable and the measure is limited in scope and duration.

To return to the specific example of tax rulings, where corporate tax liability was reduced based on a specific transfer pricing arrangement, the current three-step selectivity test focuses on whether the arrangement deviates from the normal domestic tax regime and whether this confers a selective advantage. Under the newly defined two-step test, after establishing comparability in the first step (i.e. comparing the undertaking in question with other companies subject to similar transfer pricing rules), the second step would allow MS to justify the selective treatment. Thus, the first step would be to determine whether a tax ruling results in unequal treatment by assessing the comparability of the undertaking receiving the ruling with other undertakings in similar situations. The benchmark would be other companies subject to the same domestic transfer pricing rules under the general tax regime. Is the undertaking that benefited from the ruling in a comparable situation to these companies? The Court would assess whether the company operates under the same market and regulatory conditions as other companies that have not received a similar ruling. In other words, are the transfer pricing rules applied to other companies enforced differently or less strictly? If the undertaking receiving the ruling is objectively comparable to other undertakings subject to the same transfer pricing rules, the measure results in unequal treatment. Subsequently, in the second step, the MS must clearly formulate a legitimate policy objective that is in line with the internal logic of the system and that the tax ruling is intended to achieve. For example, MS could argue that the ruling was intended to attract investment or ensure consistency in transfer pricing methodologies. However, the proportionality test would require them to demonstrate that the selective treatment was necessary and proportionate to achieve those objectives. The Court would have to assess whether the tax ruling was suitable to achieve the objective and whether there were less restrictive means, such as applying a uniform transfer pricing rule to all companies without offering the company in question a special arrangement. If the Court finds that the selective ruling did not pursue a legitimate aim or was not proportionate, i.e. if it went beyond what was necessary to achieve its policy objective, then the measure would be considered unlawful under the State aid rules.

As regards the consideration of a consistency standard, it does not substantively add anything new to the assessment, but is as such already part of the proportionality assessment. Consistency is a very broad notion, which would require a certain familiarity with the respective national tax law in the broader sense. However, this is difficult for the Commission and the Courts to understand. Furthermore, there may be several possible interpretations: On the one hand, it can mean that the measure is designed in way that does not contradict its own objective and is reasonable to achieve it or, on the other hand, that there are no differentiations between comparable situations. Accordingly, there is no need for an explicit consistency criterion, as this is already covered by proportionality.

Similarly, the standard proposed by AG Kokott is to be rejected. In *Engie*, she proposed to put a greater emphasis on the analysis whether the unequal treatment is justified and to reduce the State aid control for general tax laws to a control of abuse. Thus, under the new standard of review only tax measures designed in a manifestly discriminatory manner, i.e. manifest derogations, or serious errors would be scrutinised.[916] However, it is again a matter of interpretation as to what is meant by 'manifest' and 'serious error' and leaves wide scope for MS to abuse their tax powers to circumvent the requirements of EU law by hiding behind appealing tax objectives.

5.5.3. Examples of Application to Existing Case Law

In order to show that the two-step test works in all cases of the current three-step selectivity test, it is applied to certain scenarios of State aid. In particular, it is applied to the cases mentioned in Chapter 3.2.1., which deal with the definition of the reference system, to demonstrate that its determination is no longer necessary.

The first example is a case concerning special purpose levies, the infamous *British Aggregates* case.[917] As a reminder, the case concerned an aggregates levy, i.e. an environmental tax on quarrying activities, introduced by the UK to cover the environmental costs of extracting natural aggregates. Certain materials, however, such as recycled or secondary aggregates, were exempt from the levy. The British Aggregates Association challenged the tax, arguing that the exemptions constituted unlawful State aid. The application of the two-step test would first, within the context of the comparability analysis, examine the question of whether the exempted materials are comparable to the taxable materials in terms of the objective of the measure, namely to reduce environmental damage caused by the extraction of primary aggregates. Without having in-depth knowledge on the subject of the extraction of aggregates, one could argue for and against comparable products: On the one hand, recycled or secondary aggregates

[916] Joined Cases C-451/21 P and C-454/21 P *Engie Global LNG Holding and Others v Commission* [2023] ECLI:EU:C:2023:383, Opinion of AG Kokott, paras 92 and 101.
[917] C-487/06 P *British Aggregates v Commission* [2008] ECR I-10515; see also Chapter 3.2.1.1.

may be considered not fully comparable with primary aggregates due to a different degree of environmental harm. In the case of such a lack of comparability, the assessment would end here. On the other hand, as the GC stated in its renvoi decision,[918] both types of aggregates can be considered comparable in terms of their use with regard to the environmental objective. In this case, the tax differentiation would give rise to a prima facie selective advantage. In defence of the measure, the UK argued that the exemption of recycled and secondary aggregates encouraged environmentally friendly practices. In the second step, therefore, the Court would have to assess whether the exemption was necessary and whether the same objective could be achieved by less distortive measures. On the one hand, the exemption could appear proportionate, since taxing recycled materials would discourage their use, contrary to the environmental objective. This would justify the measure as proportionate. On the other hand, as ultimately decided by the GC on renvoi,[919] given the environmental objective and the general nature of the tax system for aggregates, there was no tendency towards a demand for secondary aggregates, but rather the opposite, which attenuated the desired effects and thus could not justify a different tax treatment.

The second example is the case *P Oy* on loss carry-forward rules.[920] The case concerned Finnish corporate income tax rules that limited the benefits of loss carry-forward to companies that are undergoing restructuring only under certain conditions. As a first step, companies undergoing restructuring that are not entitled to loss carry-forward would have to be compared to companies undergoing restructuring that are entitled to loss carry-forward and to other loss-making companies not undergoing restructuring. Again, the outcome would be a matter of interpretation. According to the Finnish government, the objective of the measure was to prevent tax avoidance and to support the viability of businesses. It is certainly arguable that companies undergoing restructuring, whether eligible or not, are in a comparable situation. Moreover, from a tax neutrality point of view, loss-making companies undergoing a change of ownership may be in a comparable situation to loss-making companies not undergoing such a change. However, it can be said that a company undergoing a change of ownership is still in a different situation from a company not undergoing such a change. In view of the objective of preventing tax avoidance, maintaining tax neutrality and preserving the profitability of companies, one could assume that the categories of companies are in an objectively comparable situation. Part of the system also concerned the role of the administration, which decided which

918 Case T-210/02 RENV *British Aggregates v Commission* [2012] ECLI:EU:T:2012:110.
919 Case T-210/02 RENV *British Aggregates v Commission* [2012] ECLI:EU:T:2012:110, paras 83-91.
920 Case C-6/12 *P* [2013] ECLI:EU:C:2013:525.

companies could continue to benefit from the measure in the event of a change of ownership. In this case, it would also be necessary to examine the extent to which the authority has discretion here or only applies the relevant criteria. Regarding justification, the Finnish government argued that the aim of the loss relief system was to maintain real economic recovery and jobs in viable businesses. Accordingly, if the scope of the measure is not too broad, it could therefore be justified. The measure could therefore stand if it is narrowly framed, by granting the advantage only to businesses with a demonstrable need for restructuring and by excluding those that use the scheme to avoid taxes.

The case *Commission v Poland* is selected as an example of cases of progressive taxation.[921] The case concerned the Polish progressive retail turnover tax, where companies with higher turnover had to pax higher tax rates. In terms of comparability, the relevant question is whether companies with different levels of turnover are comparable with regard to the objective of the measure. The progressive turnover tax aimed to tax larger companies with greater financial capacity to contribute to public finances more heavily, reflecting the principles of progressivity and redistribution. The result would be that companies with different levels of turnover are comparable, as all taxable units operate within the same economic framework, namely the retail sector, and are taxed on their turnover. Due to the nature of the system, the progressive tax rates result in unequal treatment, from which smaller companies benefit, as they have lower effective tax rates. In this case, the objective of the measure and the system are broadly aligned. Thus, the proportionality test would examine whether the progressivity was applied in a manner that was necessary and proportionate to achieve the objectives of redistribution. The Court would assess whether the tax thresholds and rates were designed in such a way that redistribution could be achieved without unjustified distortions of competition. Among others, the Court would examine whether the progression disproportionately excluded larger companies from the market or gave smaller companies an unjustified advantage. Applying this two-step test, the Court would come to the same conclusion, namely that the measure is proportionate to its objectives and does not constitute unlawful State aid, as the different treatment was justified by Poland's legitimate policy objectives.

These three examples are representative of the application of a two-step test and can also be applied to other categories of tax. The two-step test provides a clearer and more focused

[921] Case C-562/19 P *Commission v Poland* [2021] ECLI:EU:C:2021:201.

framework for argumentation that makes the analysis more accessible and transparent by prioritising comparability and justification over abstract definitions.

5.5.4. Added Value of a Newly Defined Two-Step Test

The proposed two-step test has several key advantages over the existing three-step approach. By focusing first on comparability rather than determining a reference system, the two-step test simplifies the initial assessment. The comparability analysis is conceptually clearer and less technical, focusing on whether the undertakings in question are similar in terms of the objectives of the measure, rather than whether the measure derogates from a 'normal' system. This reduces the complexity of the process and avoids the often confusing and arbitrary determination of reference systems, particularly in complex tax systems. It also allows for greater flexibility in the assessment of justifications, similar to the rule of reason in fundamental freedoms cases. By widening the range of justifications that can be considered, including broader public policy objectives, MS have more leeway to defend their tax measures. However, this flexibility is balanced by the proportionality test, which ensures that selective measures are not overly broad or excessive.

The two-step test is more in line with the methodology applied in fundamental freedoms cases, which focuses on comparability and justification. This will create greater consistency between the application of State aid law and the principles of the internal market, in particular the free movement of workers, services, companies and capital. By harmonising the methodologies, this approach reduces the potential for conflicting legal interpretations and increases legal certainty for both MS and taxpayers. More legal certainty is provided by focusing on concrete and objective factors, the comparability of the undertakings involved and the justification for any unequal treatment. This clarity would allow MS to better predict how their tax measures will be assessed and give businesses a clearer understanding of whether they are likely to be subject to State aid investigations.

The redefinition of the selectivity test as a two-step test, focusing first on comparability and then on justification and proportionality, offers a more coherent and streamlined framework for assessing fiscal State aid. By simplifying the initial comparability analysis and extending the scope for justification, this approach provides greater flexibility while maintaining strict controls to prevent undue distortions of competition. The proportionality test ensures that selective measures remain appropriate and necessary for achieving legitimate policy objectives.

5.6. Do All Roads Lead to Rome? Exploring Alternative Paths to Selectivity

The concept and methodology of selectivity in State aid law have evolved considerably, necessitating the examination of alternative approaches to its application. A new trend is the focus on the notion of 'selective advantage', further blurring the lines between the selectivity and advantage tests. The legal framework adopted during the Covid-19 pandemic, which provided for a temporary and flexible State aid regime, offers important insights into how State aid rules can be adapted while maintaining fair competition, referring to the notion of non-discrimination. Additionally, the CCTB, now BEFIT, proposal presents a potential alternative for mitigating selective tax measures in MS by creating a more harmonised corporate tax system. Finally, the chapter will briefly explore the relationship between competition law and the principle of equal treatment and shows how insights from competition law can provide a more consistent approach to selectivity in State aid. Alongside these alternatives, the growing need for greater transparency in the case law of the CJEU, particularly in terms of setting aside outdated precedents and clarifying the developments of legal principles, remains a pressing issue.

While these developments undoubtedly have an influence on State aid rules, none of them alone is sufficient to comprehensively redefine the selectivity assessment. They do not consistently address the core challenges of selectivity and do not offer suitable alternatives to the streamlined and more effective two-step test proposed in this research.

5.6.1. Better Standard? The Trend of Selective Advantage[922]

In assessing the infringement of Art 107 TFEU, the Court and particularly the Commission confuse the criteria of selectivity and advantage.[923] This confusion is especially evident in recent tax ruling cases. Instead of following the traditional three-step approach, first a reference system is established, then it is determined whether there is an advantage and only after, steps two (derogation) and three (justification) are examined. Although the ECJ has recognised advantage and selectivity as distinct criteria with distinct aims, i.e. the improvement of the financial situation of the beneficiary and the fact that this advantage does not benefit other undertakings in a factual and legal comparable situation in view of the objective of the system, it has also noted that these criteria can be examined together as a single condition (selective advantage).[924]

[922] See also Daniela Gschwindt, 'The dynamics of selectivity in tax ruling cases' (2024) EU Law Live.
[923] Cf Thomas Jaeger, 'Tax Incentives under State Aid Law: A Competition Law Perspective' in Isabelle Richelle, Wolfgang Schön and Edoardo Traversa (eds), *State Aid Law and Business Taxation* (2016 Springer) 39ff.
[924] Case C-15/14 P *Commission v MOL* [2015] ECLI:EU:C:2015:362, paras 59-60.

A recent example is the case of *Fachverband Spielhallen* from 2023, which concerned the deductibility of a levy borne by a public casino in North Rhine-Westphalia. While the GC acknowledged that the criteria of advantage and selectivity must be examined sequentially and even jointly, insofar as it is a question of proving a reduction in the amount of tax normally due, it found that there was no economic advantage at all for the operator of the public casino and that selectivity therefore no longer needed to be examined.[925] On appeal, the ECJ disagreed with the GC and established a clear link between the concept of advantage and that of selectivity. It did so by emphasising that the selectivity test coincides with the examination of advantage as far as the identification of the reference system or the normal system is concerned. Hence, it clarified that the identification of the normal tax system is equally relevant for both selectivity and advantage.[926] The Court previously held that the fact that the Commission includes the analysis of advantage in the assessment of selectivity does not constitute a failure or impairment of the analysis, provided that both concepts are assessed.[927] Hence, the ECJ has indicated that fulfilling the advantage criterion generally implies a presumption that selectivity is also met, but the Commission appears to ignore the separation of these two conditions, assuming a selective advantage exists when a tax ruling results in an outcome that deviates from what would arise from the normal application of the ordinary tax system (to an independent company).[928] In principle, Commission bases itself on the presumption of selectivity and only carries out the formal analysis due to completeness.

This approach equates the application of the 'normal' tax system with the approximation of a market economy result, which is problematic as the methodology for determining selectivity is not coherent in itself and now adds another layer of complexity by conflating these criteria. The merging of selectivity and advantage undermines the clarity of the selectivity analysis.[929] Under these two conditions, a different type of comparison is made. Selectivity, on the one hand, is concerned with whether a measure favours certain undertakings over others in similar legal and factual circumstances. Selectivity as such compares the treatment in the presence of a measure with the treatment in the absence of a measure, the 'normal' treatment, so to speak. Advantage,

[925] Order T-510/20 *Fachverband Spielhallen and LM v Commission* [2021] ECLI:EU:T:2021:745, paras 50ff.
[926] Case C-831/20 P *Fachverband Spielhallen and LM v Commission* [2023] ECLI:EU:C:2023:686, paras 35ff; cf Joined Cases C-182/03 and C-217/03 *Belgium and Forum 187 v Commission* [2006] ECR I-5479, paras 95-97 in combination with para 121.
[927] Case T-131/16 RENV *Belgium v Commission* [2023] ECLI:EU:T:2023:561, paras 87-91.
[928] 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' OJ C262, 19 July 2016, para 170; *Fiat* (SA.38375) Commission Decision (EU) 2016/2326 [2015] OJ L351, para 217; *Starbucks* (SA.38374) Commission Decision (EU) 2017/502 [2015] OJ L83, para 253.
[929] Equally critical Wolfgang Schön, 'State Aid in the Area of Taxation' in Leigh Hancher, Tom Ottervanger and Piet Jan Slot (eds), *EU State Aids* (6th edn, Sweet & Maxwell 2021) paras 33-36; Thomas Jaeger, 'From Santander to LuxLeaks – and Back' (2015) EStAL 3.

on the other hand, focuses on whether the measure provides an economic benefit that would not otherwise exist. Accordingly, a counterfactual analysis takes place here. Combining these assessments not only blurs these distinct concepts, but also risks inconsistent application of the law. Although the Court aims to streamline the assessment process for efficiency, the blurring of selectivity and advantage introduces significant methodological challenges to applying the traditional three-step test.

There is a risk that important contextual and justifying factors, such as the specifics of national tax systems and the rationale behind certain tax rulings, are overlooked. Different cases can be and are already subject to varying interpretations and standards, undermining the uniform application of EU law and leading to legal uncertainty for MS and businesses. Additionally, in such a scenario, the burden of proof is shifted from the Commission to the parties, who must demonstrate that an advantage is not selective.[930] This denies MS and affected parties a comprehensive assessment of all elements of Art 107 TFEU.

5.6.2. Adaptation of the Legal Framework for State Aid – Lessons from Covid?

In the event of unforeseen events and crisis situations, the Commission has adapted the State aid legal framework accordingly in recent years. This was particularly the case in order to cushion the impact of the Covid-19 pandemic and now also the impact of the war in Ukraine on the affected economies and companies.[931]

Following the outbreak of the Covid-19 pandemic in 2020, the Commission reacted quickly and adopted a Temporary Framework to enable MS to provide timely and targeted support measures for businesses in need.[932] As a result of the pandemic, many companies have been struggling with a loss of turnover and liquidity, especially in sectors such as air transport. The temporary relaxation of State aid rules gave MS important room for manoeuvre and more flexibility in the design of aid. As a soft law instrument, the Temporary Framework established a number of temporary measures considered compatible with Art 107(3)(b) TFEU to remedy a

[930] Critically Thomas Jaeger, 'Schwächen der Prüfung von Steuerbeihilfen am Beispiel der Urteile Fiat und Starbucks' (2020) EuZW 18, 23.

[931] Commission, 'Temporary Framework for State Aid Measures to Support the Economy in the Current COVID-19 Outbreak' (Communication) COM(2020) 1863 final; Commission, 'Temporary Crisis and Transition Framework for State Aid measures to support the economy following the aggression against Ukraine by Russia' (Communication) (2023) C101/3.

[932] Commission, 'Temporary Framework for State Aid Measures to Support the Economy in the Current COVID-19 Outbreak' (Communication) COM(2020) 1863 final, this Temporary Framework was supplemented and extended by subsequent amendments; see also José Luis Buendía and Angela Dovalo, 'State Aid Versus COVID-19: The Commission Adopts a Temporary Framework' (2020) EStAL 3.

serious disturbance in the economy of a MS and to allow for a quicker and more flexible approval of aid.

By imposing travel restrictions and bans, the pandemic has hit the aviation market, among others, very hard. MS intervened to support airlines in difficulty, invoking Art 107(2)(b) TFEU or the Temporary Framework and thus Art 107(3)(b) TFEU. Art 107(2)(b) TFEU authorises aid to make good the damage caused by natural disasters or other exceptional occurrences. On the basis of the Temporary Framework, more than 30 aid schemes for airlines have been notified to the Commission, around half of which were notified on the basis of Art 107(3)(b) and Art 107(2)(b) TFEU respectively.[933] In two judgements from 2021, the GC ruled for the first time on the validity of Commission decisions in connection with Covid-19 aid. Many of the proceedings were brought by the low-cost airline Ryanair, which felt discriminated against by, among other things, a tax payment moratorium introduced in France and a regulation introduced by Sweden on loan guarantees to support airlines. The actions are essentially based on the same pleas in law, including breach of the principle of equal treatment and breach of the freedom to provide services. The French and the Swedish measures and the respective judgments will be presented shortly in order to clarify whether they have brought new insights for State aid law, in particular with regard to the argument of discrimination and the relationship between State aid rules and the principle of non-discrimination.[934]

In March 2020, France notified the Commission of an aid measure in the form of a deferral of payment of the monthly civil aviation tax and the solidarity levy on airline tickets from March to December 2020. This deferral benefitted airlines with a French licence and consisted of deferring the payment of these taxes until January 2021 and then spreading the payments over a period of 24 months. The scheme was intended to ensure that airlines are able to maintain sufficient liquidity until the restrictions or bans on air traffic were lifted and normal business activities resume. The Commission classified the deferral of the tax payment as aid compatible with the internal market in accordance with Art 107(2)(b) TFEU.[935] Ryanair (holder of an Irish licence) brought an action for annulment against the decision and accused the Commission of disregarding the damage caused to pan-European airlines during the pandemic and thus allowing MS to reserve aid exclusively for certain airlines.

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[933] Tania Pantazi, 'State Aid to Airlines in the Context of Covid-19: Damages, Disturbances, and Equal Treatment' (2022) 13(4) JECLAP 268, 270-271.

[934] For an overview of the various judgments involving Ryanair see also Christopher McMahon, 'State Aid Junkies, Viruses and the Aviation Industry: Ryanair's Litigation against Approved Aid Measures for Airlines During the Pandemic' (2021) EStAL 249.

[935] Case T-259/20 *Ryanair v Commission* [2021] ECLI:EU:T:2021:92, paras 1-7.

First, the GC examined the Commission's decision in the light of Art 18(1) TFEU, which prohibits any discrimination on grounds of nationality, without prejudice to (and without affecting) the special provisions of the Treaties. The Court held that Art 18 TFEU is only applicable where there are no more specific provisions applicable to the case at hand. This was not the case, because Art 107(2)(b) was to be seen as a special provision and allows for derogations and unequal treatment when the conditions are fulfilled. In the light of the findings of the Court, the objective of the deferral met the requirements of the derogation provided for in Article 107(2)(b) TFEU.[936] Second, the GC examined the Commission's decision with regard to the freedom to provide services under Art 56 TFEU. In this respect, it pointed out that this fundamental freedom as such does not apply to the air transport sector, which is subject to a special Regulation 1008/2008.[937] The purpose of that regulation is precisely to lay down the conditions for the application of the principle of freedom to provide services in the air transport sector. However, Ryanair did not claim a violation of this regulation. Hence, the action was dismissed. The GC's decision was upheld by the ECJ on appeal.

In April 2020, Sweden notified the Commission of an aid measure in the form of a loan guarantee scheme to support air carriers holding a Swedish operating licence. This scheme was aimed in particular at air carriers that held a Swedish licence for commercial air transport activities, with the exception of air carriers operating unscheduled flights (charter flights). The aim of the scheme was to secure Sweden's connectivity and ensure sufficient liquidity. The Commission declared the scheme compatible with the internal market pursuant to Art 107(3)(b) TFEU. Ryanair again brought an action for annulment, which was dismissed again. In this case, the judgement focused on Art 107(3)(b) and not Art 107(2)(b) TFEU and also on Art 18(1) TFEU and the freedom to provide services.[938]

In order to verify whether Art 18 TFEU was infringed, the Court again checked whether the conditions of Art 107(3)(b) were fulfilled and confirmed that the scheme indeed was aimed at remedying a serious disturbance in the Swedish economy caused by the pandemic, in particular the significant negative impact on the aviation sector and air transport services in Sweden. The Court found that the restriction of the scheme to air carriers holding a Swedish licence was appropriate to achieve that objective. According to the GC, the provisions created reciprocal

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[936] Case T-259/20 *Ryanair v Commission* [2021] ECLI:EU:T:2021:92, paras 22ff; Case C-210/21 P *Ryanair v Commission* [2023] ECLI:EU:C:2023:908, paras 38ff.

[937] Case T-259/20 *Ryanair v Commission* [2021] ECLI:EU:T:2021:92, para 55; Case C-210/21 P *Ryanair v Commission* [2023] ECLI:EU:C:2023:908, paras 81ff; cf Case C-320/21 P *Ryanair v Commission* [2023] ECLI:C:EU:2023:712.

[938] Case T-238/20 *Ryanair v Commission* [2021] ECLI:EU:T:2021:91, paras 1ff.

obligations between the air carriers holding a Swedish licence and the Swedish authorities and thus a specific and stable link between them. With regard to the proportionality of the loan guarantee scheme, the Court further stated that the airlines eligible for the aid scheme made the largest contribution to Swedish scheduled air traffic in both freight and passenger transport. Extending the aid scheme to airlines not established in Sweden would not have made it possible to achieve that objective. Hence, the objective of the loan guarantee scheme fulfilled the conditions of the derogation in Art 107(3)(b) TFEU and the scheme did therefore not constitute prohibited discrimination.[939] As regards the argument on the violation of the freedom to provide services, it applied the same reasoning as in the French case.[940] Again, the decision was upheld by the ECJ on appeal.

By considering Arts 107(2)(b) and 107(3)(b) TFEU as special provisions under Art 18(1) TFEU, the Court implicitly states that the principle of equal treatment is implemented in the State aid rules.[941] Although an impairment of the prohibition of discrimination was explicitly addressed in these cases, it can be stated that Art 18 TFEU is applied restrictively in State aid law if the conditions (here of Art 107(2)(b) and (3)(b) TFEU) are met. Not only was there no discrimination here, but conversely, an extension of the regulations to non-resident airlines would have led to disproportionality. For this reason, these judgements do not provide any new insights into the inclusion of equal treatment in State aid law. It should be noted that the Temporary Framework for Covid-19 aid has already expired, but that some of the judgements are still pending.

5.6.3. EU Common Corporate Tax Base – An Alternative?

The Commission has been trying for years to create a common corporate tax base. The 2023 BEFIT proposals of the Commission revisit this issue and attempt to continue previous attempts by the CCTB and CCCTB, which were subsequently withdrawn by the Commission. Their aim is to reduce the costs associated with cross-border transfer pricing (withholding taxes) and to further harmonise profit shifting and the tax bases.

The old CCCTB proposal aimed to create a common corporate tax base for multinational companies with an annual turnover of over EUR 750 billion and to determine their tax liability

[939] Case T-238/20 *Ryanair v Commission* [2021] ECLI:EU:T:2021:91, paras 25ff; Case C-209/21 P *Ryanair v Commission* [2023] ECLI:EU:C:2023:223, paras 33ff.
[940] Case T-238/20 *Ryanair v Commission* [2021] ECLI:EU:T:2021:91, paras 59ff; Case C-209/21 P *Ryanair v Commission* [2023] ECLI:EU:C:2023:223, paras 70ff.
[941] Cf Juan Jorge Piernas Lopez, 'The COVID-19 State Aid Judgements of the General Court…Every Man for Himself?' (2021) EStAL 258.

at MS level.[942] The BEFIT proposal targets the same group of taxpayers but requires them to file an additional tax return for the entire group. Smaller groups can opt to participate. The tax base of all members of the group is aggregated into a single tax base, with losses automatically offset against cross-border profits. Here too, the tax liability is determined in accordance with national rules. BEFIT allows losses to be carried forward indefinitely and losses to be offset between subsidiaries. Moreover, the proposal uses the amortisation or depreciation method to deduct investment costs from taxable income. The corporate tax base would be apportioned between MS by the share of BEFIT income from each MS, calculated on the basis of the average of the taxable results of the previous three tax years.[943]

The proposal for a directive on transfer pricing aims to incorporate the ALP into EU law, harmonise the main transfer pricing rules, clarify the role and status of the OECD Transfer Pricing Guidelines and create the possibility to establish common binding rules on certain transfer pricing issues. In this way, a more coherent approach to the interpretation and application of transfer pricing rules is sought.[944]

The question that arises is whether such a proposal represents a compromise between MS sovereignty and EU scrutiny. The old CCCTB proposal was already too ambitious for the MS, which could not agree on it.[945] The fact that the scope of the BEFIT proposal is now also hybrid, in that it is mandatory for some companies and optional for others, unfortunately does not serve the objective of reducing the administrative burden. On the contrary, two different tax systems would coexist in a MS: the national tax system on the one hand and the BEFIT system on the other. Therefore, optionality will neither eliminate the discrepancies between the national systems nor lead to simplification and standardisation.

The adoption of the proposal on common transfer pricing rules and the formal introduction of an EU ALP is rather unlikely, as the MS have not yet adopted all of these rules into their national law and are likely to oppose such a project. The very issue that is to be addressed or harmonised here is controversial in recent tax rulings. It is precisely the freedom of the MS with regard to transfer pricing and the individual cases and applications of transfer pricing rules that make the

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942 Commission, 'Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB)' COM(2016) 683 final.

943 Commission, 'Proposal for a Council Directive on Business in Europe: Framework for Income Taxation (BEFIT)' COM(2023) 532 final; Commission, 'Business in Europe: Framework for Income Taxation (BEFIT)' (Taxation and Customs Union) <https://taxation-customs.ec.europa.eu/taxation/business-taxation/business-europe-framework-income-taxation-befit_en> accessed 17 September 2024.

944 Commission, 'Proposal for a Council Directive on transfer pricing' COM(2023) 529 final.

945 For a critical assessment of the CCCTB proposal, see Lisa Aumayr and Gunter Mayr, 'CCTB – Is There a Chance of a Breakthrough?' (2019) 59(4) European Taxation 153.

issue a very political discourse that is unlikely to be regulated by a directive, if at all at EU level.

Although the Commission is attempting to bring about normative harmonisation, these proposals are not comprehensive and are not practicable or implementable due to the unanimity requirement of Art 115 TFEU and the unwillingness of MS to relinquish their tax sovereignty. Furthermore, these proposals would not be suitable or appropriate for all types of tax and therefore cannot serve as an alternative. This makes the step towards an adapted selectivity test in the practice of the Commission and the CJEU all the more important.

5.7. Brief Excursus on Competition Law and Equal Treatment as a General Principle

A trend is emerging in case law whereby the principle of equal treatment is referred to more often not only in the context of Art 107 TFEU, but also for Arts 101, 102 and 106 TFEU. The concept of non-discrimination is thus being extended to various areas of EU law, making it a genuine general principle of EU law. Probably the most significant development in this context, which has recently attracted a lot of attention, is the case of *Google Shopping*, which is briefly described here.

In the 2021 *Google Shopping* case, the GC confirmed the Commission's finding that self-preferencing should be considered a new independent form of abuse under Art 102 TFEU. The abuse in this case concerned the extension of Google's market power from general searches to price comparison searches through self-preferencing. While the results from other shopping comparison services could only be found in the generic results, the typical links, the results of Google Shopping were displayed at the top, separately and with images. As a result, Google's offer was more visible to consumers and generated more traffic and sales. Referring to cases in which discrimination was considered an abuse, the GC described the principle of equal treatment as a general principle of EU law and stated that abuse can take the form of unjustified differential treatment.[946] Although there is no general duty not to discriminate,[947] the GC found that discrimination must have an exclusionary effect.[948]

With respect to the applicability of the essential facilities doctrine, the GC emphasised that the characteristics of the results page of Google were similar to those of an essential facility, but

[946] Case T-612/17 *Google and Alphabet v Commission (Google Shopping)* [2021] ECLI:EU:T:2021:763, para 155; cf Case C-52/09 *TeliaSonera Sverige* [2011] ECR I-527, paras 28 and 55-56.
[947] Pablo Ibánez Colomo, 'Exclusionary Discrimination under Article 102 TFEU' (2014) 51 CMLR 141, 144.
[948] Case T-612/17 *Google and Alphabet v Commission (Google Shopping)* [2021] ECLI:EU:T:2021:763, para 152.

nevertheless distinguished the case from *Bronner*.[949] Interestingly, and related to Google's quality or product improvement argument, Google claimed that the different treatment of its own shopping comparison results was not discriminatory because it had legitimate reasons for doing so. It applied different technologies for generic results and product results and thus treated different situations differently in order to improve the quality of its results.[950] The GC clarified that the discrimination did not lie in a different treatment based on the nature of the results, but in the differential treatment of their positioning and display, as Google's results were treated better (specialised results) than those of competitors (generic results).[951] The GC's decision and findings were confirmed by the opinion of AG Kokott.[952] On appeal, the ECJ agreed that the GC was right to find Google's behaviour was discriminatory and not in line with competition on the merits, given the characteristics of the market and the particular circumstances of the case.[953]

Various competition law scholars consider that many forms of abuse, such as exclusivity agreements or margin squeezes, contain discriminatory elements and argue that equal treatment has long played a role, albeit implicitly, in Art 102 TFEU and related cases. Furthermore, they argue that the application of a general principle of equal treatment in Art 102 TFEU is consistent with the purpose of the provision to comprehensively regulate unjustified discrimination by undertakings.[954] The *Google Shopping* case has shown that the general principle of equal treatment is applicable in the context of Art 102 TFEU and that discrimination can constitute an abuse under Art 102 TFEU if there is unjustified unequal treatment and an exclusionary effect. As the principle of equal treatment has already found its way into traditional competition law, it is time for this to apply to State aid law too, as this is also only a formality.

5.8. Interim Conclusion on the Trend of Convergence

Each national tax law works according to its own logic and principles. Neither the Commission nor the CJEU are able to grasp hold of all of these systems and should therefore also not

[949] Case T-612/17 *Google and Alphabet v Commission (Google Shopping)* [2021] ECLI:EU:T:2021:763, paras 176-246.
[950] Case T-612/17 *Google and Alphabet v Commission (Google Shopping)* [2021] ECLI:EU:T:2021:763, para 272.
[951] Case T-612/17 *Google and Alphabet v Commission (Google Shopping)* [2021] ECLI:EU:T:2021:763, para 284.
[952] Case C-48/22 P *Google and Alphabet v Commission (Google Shopping)* [2024] ECLI:EU:C:2024:14, Opinion of AG Kokott.
[953] Case C-48/22 P *Google and Alphabet v Commission (Google Shopping)* [2024] ECLI:EU:C:2024:726, paras 175-193.
[954] Eg Lena Hornkohl, 'Article 102 TFEU, Equal Treatment and Discrimination after *Google Shopping*' (2022) 13(2) JECLAP 99; Friso Bostoen, 'The General Court's *Google Shopping* Judgment Finetuning the Legal Qualifications and Tests for Platform Abuse' (2022) 13(2) JECLAP 75; Pablo Ibánez Colomo, 'Editorial: Will Article 106 TFEU Case Law Transform EU Competition Law?' (2022) 13(6) JECLAP 385.

substitute their own understanding of the right tax law to a specific case. This calls for clear guidelines on how unequal treatment should be assessed for tax purposes.

The selectivity test as it stands now is not able to offer a holistic approach for the assessment of tax measures. There is no standard set of comparators used to distinguish selective from general measures. Despite the Commission's Notice, there are actually no real guidelines on how to properly construe and perform the selectivity assessment. It attempts to combine the classic, and already partly discarded, approach of derogation with the approach of the CJEU, which is based on a comparability test. However, the Court also assesses situations on a case-by-case basis using different criteria. This also applies within the institution, which is why the ECJ, the GC and the AGs often disagree on which method to choose. Furthermore, the CJEU considers the Commission's approach more and more often to be incorrect (see tax rulings and the European ALP) or inconclusive or incomplete. Despite these discrepancies, the individual elements which already now form part of the comparability approach of the second step can be recycled. It is enough to get rid of the three-step grid or pattern and to concentrate more on the actual treatment of undertakings when they are compared to companies in similar situations, having regard to the legal and factual circumstances in light of the objective of the measure. As far as the level of justification is concerned, it is also not entirely clear which objectives are considered legitimate. This is further complicated by the distinction between external and internal reasons. Such a categorisation is actually not necessary.

The fundamental freedoms allow for a more flexible approach in that no reference system and the corresponding derogation have to be formed. Undertakings or taxpayers are compared with regard to their factual and legal circumstances and in light of the objective of the measure in order to determine the existence of unequal treatment. The justification options within the framework of the fundamental freedoms also offer more flexibility. By applying the rule of reason, MS can put forward several justifications, which are then checked for compatibility placing a greater emphasis on their proportionality. Although the approach towards finding discrimination by tax measures under the fundamental freedoms seems promising at first sight, it must be noted that the comparability assessment is performed at different levels of the assessment depending on the fundamental freedom involved. In some cases, this also flows into the final step of justification.

The modified test proposed in this chapter aims to combine best parts of both in order to create a selectivity test for Art 107(1) TFEU that provides for a comprehensible methodology and hence greater legal certainty for States and taxpayers. In this test, the first step, namely the creation or recognition of a reference system, is omitted. Instead, this test focuses on the second step, similar to the fundamental freedoms. The new first step is therefore the comparability test, as known already. Once the scope of application is determined, i.e. the application of a certain measure in favour of a company, the undertaking is compared with companies in a comparable legal (i.e. also falling within this scope) and factual situation. For this purpose, the objective of the measure is taken into account to ensure that these companies are indeed comparable. By implication, comparability includes identifying the relevant rule applicable and the undertakings falling thereunder to be able to compare them (i.e. legal treatment). The comparability approach is already followed both under the State aid law and the fundamental freedoms. Here it becomes significant that the same comparators are chosen and adhered to for a consistent methodology. The second step, the justification level, resembles that of the existent one. Merely the distinction between internal and external reasons is abandoned, moving towards a kind of rule of reason, similar to that of the fundamental freedoms. This gives MS more room for manoeuvre when designing their tax policies. In any case, great attention is paid to the proportionality aspect of justification, which balances out this leeway by ensuring that only truly legitimate reasons are allowed. Thus, the new review standard allows a certain degree of flexibility to take into account the specifics of each individual case.

Furthermore, it should be noted that merging the conditions of selectivity and advantage does not add any value to the methodology for determining unequal treatment. On the contrary, merging inconsistent standards creates even more ambiguity as to how a harmonised approach should be pursued. The same applies to the Commission's unsuccessful attempts to create harmonisation through secondary law, in particular the proposed directives. Although the Covid case law provides a clear link between the equality standard and the State aid rules, it does not bring any helpful new insights for the specific approach of Art 107(1) TFEU. In addition to these judgements, the case law on competition law (Art 102 TFEU) also refers to an equal treatment criterion. These developments should serve as inspiration when it comes to creating a clearer direction in methodology. In addition, the CJEU should place more emphasis on communicating clearly when it no longer follows a line of case law. In recent years and with the emergence of increased scrutiny of tax aid by the Commission, particularly in the form of tax rulings, case law has developed and multiplied accordingly. However, this has not always happened in a coherent manner, which is why it would be important for the CJEU to bring more structure back into its methodology. This is particularly important in view of the fact that the

Commission can recover aid up to ten years after the first procedural steps have been taken.[955] The current practice undermines legal certainty, which is needed more than ever due to the increasing international interdependence and integration of businesses and the increased need for binding statements for multinational companies. Therefore, updated State aid guidelines or the formal introduction of a modified selectivity test, as proposed here, are necessary.

[955] Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union [2015] OJ L248, Art 17.

6. Overall Conclusions

The conclusions of the thesis are summarised and presented chapter by chapter. This serves to provide a better understanding of the purpose of the study and its course, and culminates in the answer to the research question.

6.1. Conclusions on Chapter 2: Normative Framework of Fiscal State Aid

Taxation is a very sensitive and important competence of States and for national sovereignty, as reflected in the Treaties where Arts 113 TFEU (indirect taxes) and 115 TFEU (functioning of the internal market) require unanimity. While direct taxation is MS competence, it must align with EU law, including fundamental freedoms and State aid rules, as confirmed by the CJEU.

Fiscal State aid can have both positive and negative effects. A major concern is that it encourages aggressive tax competition among MS, as they compete to attract the most profitable investments and position themselves as a favoured location for business. More recently, the Commission has seized its opportunity to Europeanise national direct taxation laws by intervening whenever there are small gaps in tax policy. Art 107(1) TFEU is central to assessing fiscal State aid but presents challenges due to inconsistent application, particularly in the selectivity criterion, which is often conflated with the criterion of economic advantage. The methodology applied under the criterion of selectivity differs from case to case, from institution to institution and from adjudicating body to adjudicating body within an institution. The scope for interpretation of this provision is largely utilised by the Commission and repeatedly examined by the CJEU. Fundamental freedoms, such as the free movement of workers, freedom of establishment, freedom to provide services and the free movement of capital also apply to cases of direct taxation. In principle, the four-stage test applies to all these fundamental freedoms, though the application of the comparability test varies depending on the freedom involved.

The application of State aid law to tax legislation presents a great challenge as consensus among the MS is not easily achieved. Aligning tax laws across MS remains difficult, with efforts like the CCCTB proposal and its successor, the BEFIT proposal, yet to succeed. Due to international legal, economic and political developments, however, there is growing pressure to create a coordinated approach based on common standards, involving State aid rules. EU institutions have limited leeway to achieve further harmonisation beyond the development of case law. A tension exists between, on the one hand, the broad definition and interpretation of State aid aimed at preventing market and competition distortions and, on the other, the MS' exclusive competence to manage their own fiscal policies. As a result, negative integration plays a crucial role in shaping both frameworks in the area of direct taxation.

The EU is not a fiscal union and lacks a unified tax system, yet of MS must adhere to EU principles. De facto harmonisation through the case law of the CJEU causes administrative challenges for MS and their authorities, particularly due to the retroactive nature of decisions, which also offers taxpayers limited legal certainty. These rulings often impact national tax systems and are insufficient to make up for the absence of formal legislative harmonisation. The need for interpretation is evidenced by the significant number of preliminary references. Accordingly, the CJEU has gradually developed the method of assessment under Art 107(1) TFEU.

6.2. Conclusions on Chapter 3: Unravelling the Criterion of Selectivity by Exploring Inconsistencies and Shortcomings in Fiscal State Aid Law

Essentially, selectivity under Art 107(1) TFEU consists of a three-stage test, which comprises a derogation in combination with a comparability approach and a subsequent justification test.

Probably the biggest stumbling block of the selectivity and three-step test is the definition of normal taxation and the related question of who determines this: the Commission, the CJEU or the MS? The first criterion demands the determination of the reference system. As this first step forms the basis of the test, it is the most important. It is therefore all the worse that this is where most of the discrepancies arise. In this thesis, different categories of taxes were analysed to show the shortcomings of the methodology. The different approaches were illustrated using the examples of special purpose levies and loss carry-forward rules. The case law on progressive taxation and tax rulings clearly establishes that the reference system must always be grounded in national law as defined by the national legislator and cannot be derived from EU law. The European courts are limited to reviewing national law for inconsistencies and errors in its logic. While a benchmark is necessary to assess whether certain undertakings are being treated differently, it is not always feasible to situate the measure in question within a broader reference framework. In some cases, as acknowledged by the Court, the reference system is the tax measure itself. This means that the absence of a formal derogation does not automatically indicate the existence of a general measure. Instead, greater focus should be placed on the comparability of undertakings, as emphasised in the second step of the analysis. This approach avoids creating an artificial rule of normal taxation and instead centres on the coherence of a measure with its intended objective. Unfortunately, neither the Commission nor the CJEU have yet formulated clear guidelines on how the reference system should be construed and which features must be taken into account. It is generally determined on a case-by-case basis.

The second step involves the analysis of whether the measure derogates from the reference system and differentiates between taxpayers in a similar factual and legal situation. The classification as a general measure is a relative concept, as this largely depends on the comparison benchmarks. According to the Court, what is decisive is the effect of a measure. It is clear that companies that decide in favour of a certain transaction are in a different (better) position than those that do not. This is a natural consequence and should not lead to the classification measures as selective that are basically open to all. The meaningfulness of the distinction between general and selective measures can therefore be questioned. The introduction of tax differentiation is necessary and useful to create different incentives if it is consistent with its objective. However, the approach of taking into account the objective of the measure has evolved into a method taking into account the objective of the reference framework, system or regime. Even if this appears to be merely a question of the Court's terminology, it is not irrelevant whether the objective of the measure or of the system is taken as the starting point. In order to prove selectivity prima facie, it makes sense to focus on the objective of the measure. At the justification level, on the other hand, it makes sense to focus on the objective of the system, since the logic and nature of the system are analysed here anyway. It has been shown that neither the understanding of a derogation nor the comparators used follow a coherent pattern. Instead of trying to identify a derogation from the reference system, it would make more sense to reduce this step to a comparability analysis of undertakings in the same or a similar legal and factual situation, taking into account the objective of the measure. Selectivity is about recognising a meaningful difference between comparable situations, rather than merely identifying an exception to a presumed general rule.

To summarise the second step, it can be stated that it is very similar to the non-discrimination test employed under the fundamental freedoms. By comparing two situations that are both factually and legally similar, it is possible to determine whether one of these situations is unjustifiably treated less favourably based on the objective of the measure. In other words, it is examined whether certain companies are discriminated against by being treated differently from companies in a comparable situation because they are denied or not offered access to favourable treatment. The three-step method was not originally based on the principle of equal treatment, but was only introduced later by the CJEU, which required undertakings and situations to be comparable. Accordingly, a simple derogation from the reference system is not sufficient.

However, the case law analysed shows that the Court rarely makes clear reference to the principle of non-discrimination or equal treatment. Therefore, the reference to it should be much more clearly anchored in the case law on State aid.

Regarding the third step, the case law shows that the distinction between justified reasons and unjustified reasons is not straight forward. The justification analysis refers to different benchmarks and confuses the second and third step of the test by alternately considering the objective of the measure and the objective of the system. Instead, the focus should be on the objective of the system. It misses the very purpose of the selectivity test as a whole, which is to establish or deny selectivity and not to justify its existence. This also means that the burden of proof is shifted from the Commission to the MS. Instead, the Commission should have to explain why the objective of the tax system in question does not allow the particular measure or is incompatible with it. The assessment of the national tax objectives of the MS by the Commission and the Court can be considered as an interference with the tax autonomy of the MS, which was also central point in the decisions on tax rulings.

The special case of tax rulings shed some more light on the construction of the three-step test. Tax rulings provide legal certainty when the national tax authorities and the taxpayer agree on a transfer pricing method based on an ALP. The best-known source is the OECD ALP, which is not binding and is not adopted by every country. Tax rulings only become problematic if they are misused to circumvent the applicable laws. In cases involving tax rulings, the Commission not only examines the correctness of the method applied, but also assesses the objectivity of the tax calculation and selects the transfer pricing method it considers most appropriate. It believes that group companies and stand-alone companies should be treated equally. This means that the Commission does not compare between undertakings that receive a tax ruling but between an undertaking that receives a tax ruling and an undertaking that does not receive a tax ruling, i.e. they are not in a comparable situation. What is new about the Commission’s approach is the reference to an autonomous ALP, which is allegedly derived from Art 107 TFEU, without specifying what exactly this principle entails, how it is to be applied and to what extent a reference to the OECD is permissible. In this way, it constructs the reference system itself through an artificial ALP and self-determined transfer pricing method, and not by taking into account the applicable national laws and principles. This led to a wave of cases before the European courts. The ECJ clarified that the reference system can only be composed of national law and that the Commission must prove that there has been systematic discrimination against companies carrying out comparable transactions. Moreover, the Court warns of the danger that the Commission and the Court could become a kind of supreme tax authority and court in assessing the correct determination of the reference system. The ECJ rejected the idea of an ‘ideal’ EU version of the ALP and emphasised the importance of national law as the reference framework. The ECJ stated that national law must be chosen, but not how broadly or narrowly a reference system is to be understood or what characteristics a tax ruling must have in order to be considered aid. An immediate consequence of these judgements is that the Commission has to adapt its Notice and delete the reference to the existence of an autonomous ALP under Art 107(1) TFEU. The Commission in recent years adopted a modern interpretation of Art 107 TFEU, stretching the definition of State aid and extending the notion of selectivity. State aid law serves as a negative integration tool by prescribing prohibitions, which in turn means that European rules cannot be imposed, including an autonomous ALP. Instead, the CJEU acts as a driver of harmonisation via interpretation, which also applies to ‘European tax law’.

All in all, the Court has been rather supportive of the Commission’s evolving policy in the assessment of State aid. Although the three-step test has progressively developed, neither the Commission nor the CJEU are consistent in their language and choice of terms. The three-step test, applying the logic of the rule-exception, is combined with a much more forward-thinking comparability assessment. The difficulties in practice in dealing with different tax rules of tax systems with different scopes and legal consequences and in the application of the concept were most evident in the different approaches of the GC and the ECJ, which led to many judgements being overturned. Thus, despite the rich amount of case law on the selectivity criterion, its concept is still not unambiguously defined. In order to clarify the selectivity criterion, fixed benchmarks are needed to determine the comparability of situations, including the reference system and the objective pursued. Even the most recent decisions of the CJEU do not appear to open the way for a rethink of the definition of selectivity, but rather raise more questions than they answer. It would be desirable for the CJEU as an institution to commit itself to a clear line, as it does with the fundamental freedoms. On closer examination, and as confirmed by case law, the approach followed in the selectivity analysis is similar to the non-discrimination test as applied in the context of the fundamental freedoms, as both involve similar processes in identifying categories of subjects whose legal treatment is being compared and in assessing the justifications for different treatment.

6.3. Conclusions on Chapter 4: Lessons from the Fundamental Freedoms? The Treatment of Tax Measures and the Application of the Non-Discrimination Test in the Context of Fundamental Freedoms

In the context of fundamental freedoms, a non-discrimination test is applied to establish an infringement, whereby a four-step approach is followed. The most important elements here are the determination of unequal treatment on the basis of the comparability of situations and the associated justification analysis. Comparability is determined on the basis of certain criteria, which consist of the objective of the measure, the legal treatment and the comparison of the factual circumstances. The problem that arises is therefore a different one, namely at which level of the assessment comparability should be established. It is undisputed that comparability, as a prerequisite for the existence of discrimination, is at the centre of the examination. However, an analysis of the case law shows that the Court examines the various fundamental freedoms differently. As the fundamental freedoms are based on the idea that MS must still be able to collect tax revenues and enforce their tax policies, justification and proportionality play an important role. The grounds for justification are not limited to those provided for in the Treaty, but extend, as a rule of reason, to all plausible unwritten grounds justified by the public policy, health or security of a MS. The individual steps of the non-discrimination test may appear clear and simple, but their implementation is actually not. The Court applies the test inconsistently to different fundamental freedoms, which became clear after analysing the case law for each of the freedoms discussed. The study is limited to an assessment of the free movement of workers, freedom of establishment, freedom to provide services and the free movement of capital.

The primary discriminatory factor under Art 45 TFEU is residency. In principle, according to the Court, residents and non-residents are not considered comparable. However, if neither the country of residence nor the country of employment takes into account the personal and family circumstances of taxpayers, they will be denied benefits simply because they work in a country other than their country of residence or citizenship, which is a restriction. The non-discrimination test for Art 45 TFEU boils down to an analysis of the comparability of the situations of taxpayers, mostly residents and non-residents, and the actual impact of the denial of certain rights and benefits to which residents are entitled for non-residents. Nevertheless, equal treatment does not mean that an exact treatment will take place, but that income from abroad will be included and taken into account. With regard to the case law on the free movement of workers, the Court has over the years conducted a very consistent review. Comparability of taxpayers' situations remains the basis for the examination and is carried out immediately after establishing the applicability of Art 45 TFEU. There have been only a few exceptions where this has not been the case and where the analysis has been carried out at the level of justification.

Unlike the free movement of workers, where comparability is embedded in the analysis of the presence of a restriction, comparability in the context of the freedom of establishment is a separate step between the identification of the restriction and the justification. In practice, the Court's approach is to take a first step of simply declaring a measure to be restrictive, e.g. by stating that non-resident taxpayers do not have the same advantage as resident taxpayers. It is only after making this finding that it proceeds to compare the situations of resident and non-resident taxpayers. In some cases, the Court does not even conduct a comparability analysis, but merely refers to the disadvantage of certain measures and provisions. Sometimes the Court comes to contradictory or inconsistent conclusions, e.g. when it finds that multinational groups cannot be compared to domestic groups but still finds that Art 49 TFEU is violated. As for the content of the comparability criterion, it is indeed similar to the free movement of workers, namely that resident and non-resident taxpayers become comparable when non-residents earn all or most of their income in the same MS. Thus, the same allowances as for resident taxpayers must be granted and personal and family circumstances must be taken into account. Furthermore, comparability exists when the expenses are directly linked to the activity that generates the taxable income, as is the case with pension contributions. When considering comparability, the Court focuses on the objective of the measure or provision. At the level of justification, the argument that there are other advantages (abroad or in the same country) cannot offset a restriction or discrimination. Even the possibility of opting for a certain regime cannot offset the discriminatory effects of the law as such and cannot serve as a justification. Sometimes the comparability analysis is even combined with the justification analysis, when the objective of the measure is considered at this level. It is striking that the proportionality test receives far too little attention, despite its great importance for the MS. Currently, the Court seems to consider that different treatment always constitutes a restriction, without really analysing comparability. It therefore makes much more sense to include comparability in the first step of the test when determining whether a restriction has been established. Such an approach would be less repetitive and would interfere less with the tax competence of the MS, since the automatic determination of unequal treatment fundamentally calls into question every national tax measure. The Court does not appear to have found a clear and consistent methodology for the freedom of establishment.

There is not much case law on the freedom to provide services, as it is often considered as a secondary freedom, the infringement of which is invoked together with other freedoms, usually the freedom of establishment. The methodology applied is, however, more akin to that of the free movement of workers. Comparability is established, sometimes only implicitly, in the second step of the test, when the existence of a restriction is assessed. In practice, the Court identifies unequal treatment by comparing the situations on the basis of which it then determines whether or not a restriction exists. Similar to the free movement of workers, a residence requirement generally conflicts with Art 56 TFEU, unless it is based on specific requirements that aim, for example, to apply professional rules in the general interest that apply to every person in the state in question. Even if the ECJ does not always explicitly refer to the comparability criterion, it can always be inferred from the analysis. An analysis of the case law reveals that the justification step carries the most weight. This approach is fitting in the realm of direct taxation, as it acknowledges that not every national measure can be classified as a restriction, and MS may have valid reasons for enacting such provisions within their jurisdiction. For the other freedoms, the examination of the justification of measures is not as present and in-depth. Although the justification analysis is relatively detailed, certain measures still fail on the proportionality test, which, by contrast, is not as detailed.

The methodology for assessing the free movement of capital parallels that used for the freedom of establishment, where comparability is treated as a separate step between identifying the restriction and addressing the justification. In this context, however, the Court also integrates comparability into the justification stage. The Court initially examines whether a prohibited restriction exists, without formally considering the comparability of the situations at this stage. It is only in the next step that the Court addresses whether foreign companies are in a different situation than domestic ones. Sometimes this step is included within the justification step, sometimes it is treated as a separate intermediate step. As a result, any unfavourable treatment of a cross-border situation is essentially considered an unlawful restriction. Most cases related to the free movement of capital concern withholding taxes and inheritance taxes on real estate located outside the country of residence of the heir. As previously noted in relation to the freedom of establishment, identifying the existence of a restriction always necessitates a comparison. In practice, the Court conducts an indirect comparison by evaluating the (un)equal treatment of non-resident companies or taxpayers against the situation of resident companies or taxpayers. The methodology in the context of the free movement of capital is different in that aspect in that two comparability analyses take place, one implicit in the first step and one explicit either as a separate step or as an inherent part of the justification. In the latter case, justification becomes a three-step test, encompassing comparability, justification in the strict sense and proportionality.

The case law reveals ongoing tensions between national tax laws and EU law, as cross-border income generation increasingly impacts fundamental freedoms. While direct taxation remains the responsibility of MS, they must respect these freedoms as an external framework. The ECJ primarily assesses whether cross-border situations are treated less favourably than comparable domestic ones. Over time, the Court has acknowledged the MS' competence in tax matters by accepting unwritten justifications. This allows MS to pursue tax policies while respecting EU freedoms, though issues like disparities and double taxation persist due to the sensitive nature of direct taxation. Although the Court often changes its terminology in its vast body of case law and uses the terms discrimination, restriction, impediment and unequal treatment synonymously, the distinction that is usually made between discrimination and restriction is not (or no longer) made by the Court.

The comparability analysis obviously plays a key role in the case law on fundamental freedoms and direct taxation. If the situations under review are not objectively comparable, no violation occurs. Generally, equal situations must be treated equally and unequal situations unequally, unless situations are not objectively comparable or can be justified by an overriding reason in the general interest. The depth of the objective comparability analysis varies significantly across cases. In some decisions, it is thoroughly examined with regard to the objective of the regulation, while in others, comparability is merely affirmed or denied without explanation. In some cases, the Court skips the analysis altogether. In certain cases, the comparability analysis blurs with the justification stage of the non-discrimination test. While it relates to determining whether discrimination exists, it often seems to function as an intermediate or preliminary justification step. The Court's approach has been marked by inconsistent scrutiny and an unclear examination framework. Moreover, the ECJ assumes a prohibited restriction to a different extent depending on the fundamental freedom. This means that the test for determining discrimination is not only inconsistent in terms of the individual steps of the test, but also inconsistent depending on the fundamental freedom concerned. In the context of the free movement of workers, comparability of situations is examined when assessing whether there is restriction or discrimination (at the factual level), whereas in the context of the free movement of capital, comparability is examined only at a later stage (that of justification), which means that any unfavourable treatment is considered a restriction or discrimination and that the burden of proof lies with the MS, which must prove that the situations are not comparable. In some cases, only the overriding fundamental freedom is examined, even though several are affected. If the result of the assessment of the primary fundamental freedom is to be transferable to the others, the fundamental freedoms should therefore generally follow the same pattern of assessment. The concept of discrimination or restriction has been extended so much in case law that almost any rule or tax can be deemed restrictive. Eventually, the ECJ will need to clarify where comparability fits into the framework.

6.4. Conclusions on Chapter 5: Bridging the Gap? Trend of Convergence Between Selectivity and Non-Discrimination in State Aid Law and Fundamental Freedoms – The Need for a New Test

The current state of the selectivity test under Art 107(1) TFEU, as revealed through the case law analysis, has contributed to a climate of legal uncertainty where the outcomes of State aid cases rely heavily on the subjective interpretations of both the Commission and the CJEU judges. This unpredictability weakens the overall effectiveness of EU State aid law and fosters a regulatory environment characterised by ambiguity and inconsistency. Although the Court has made some progress in clarifying aspects of the test, these advancements have not gone far enough to resolve the arbitrary establishment of a rule and an exception. The selectivity test lacks a comprehensive framework for assessing tax measures. There is no standardised set of comparators to distinguish between selective and general measures and despite the Commission's Notice, clear guidelines for conducting the test are absent. The comparability test is the most important instrument for a coherent framework, resembling the non-discrimination test in the context of fundamental freedoms. Both tests assess legal and factual circumstances against the measure's objective. However, under the fundamental freedoms, the comparability assessment is carried out at different stages of the test depending on the freedom concerned.

Hence, a comparison of the Court's approach in the context of the fundamental freedoms and State aid rules reveals a convergence. The concepts are very close to each other, as the Court bases both sets of rules on a comparability approach, which is an expression of equal treatment. In State aid, comparability involves assessing the factual and legal situation of undertakings in the light of the objective of the measure, mirroring the fundamental freedom rules, where the Court compares a cross-border situation with a domestic situation, taking into consideration the same factors. Both approaches address unequal treatment of objectively comparable situations. The justification stage also converges in its methodology, as in both contexts it focuses on internal objectives and proportionality. The inner logic justification in State aid is in essence that of the coherence of the tax system under the fundamental freedoms. However, the non-discrimination test of the fundamental freedoms has conceptual problems, so the selectivity test needs to evolve beyond a direct adoption of the former.

A new selectivity test for Art 107(1) TFEU is proposed to provide clearer methodology and legal certainty. This test omits the reference system and starts with a comparability analysis, as used in fundamental freedoms. Once the scope of application is determined, the undertaking is compared with companies in a comparable legal and factual situation. For this purpose, the objective of the measure is taken into account. The second step focuses on justification, removing the distinction between internal and external reasons and moving towards a kind of rule of reason, similar to that of the fundamental freedoms. This gives MS more flexibility when designing their tax policies. In any case, the proportionality aspect of justification balances out this leeway by ensuring that only truly legitimate reasons are allowed. Here, the Court must strike the delicate balance between the objectives of market integration and the tax sovereignty of the MS. Hence, the proposed two-step test simplifies the analysis of selectivity in fiscal State aid cases by focusing on two key aspects: comparability and justification, while completely dispensing with the first step of defining a reference system.

Merging the selectivity and advantage criteria does not add any value to the methodology. On the contrary, merging inconsistent standards creates even more ambiguity as to how a harmonised approach should be pursued. Moreover, efforts to harmonise through secondary law have failed. While the Covid case law ties equality to the State aid rules, it offers little new insight for the approach under Art 107(1) TFEU. In addition to these judgements, the case law on competition law also refers to an equal treatment criterion. These developments should serve as inspiration when it comes to creating a clearer direction in methodology. In addition, the CJEU should communicate openly and clearly when it no longer follows a line of case law. Recent rulings on tax aid, though numerous, lack coherence and thereby undermine legal certainty. To address this, updated State aid guidelines or a formalised modified selectivity test, as proposed, are needed.

As a result, and in line with the initial hypothesis of convergence, this thesis proposes to eliminate the first step of the current three-step test, since the definition of a normal tax system is often artificial and controversial. Instead, the comparability assessment should be integrated directly into the first step and should include an analysis of whether the measure differentiates between undertakings in a comparable legal and factual situation. The justification step should be aligned with the fundamental freedoms' rule of reason doctrine, obliging MS to clearly formulate the legitimate policy objectives of a measure, demonstrate the necessity of the selective treatment to achieve those objectives and prove strict proportionality by showing that less restrictive alternatives are not feasible. In addition to all this, the CJEU should establish clearer criteria for legitimate objectives and proportionality assessments in fiscal State aid cases to ensure consistent application across cases.

6.5. Outlook and Final Remarks

State aid law still remains an area of uncertainty and inconsistency. The comparison to and the juxtaposition with the fundamental freedoms enhance these conceptual difficulties even further, but also allow for an enriching exertion of influence on the assessment of State aids. It is absolutely essential to form and establish a more unified theory and concept of the internal market, in which both the fundamental freedoms together with the free movement provisions and State aid rules are closely linked.

Based on the analyses presented, the research question regarding the convergence between the concepts of selectivity and non-discrimination can be answered as follows: There is clear evidence of a fundamental convergence between the two frameworks. Both assessments share core criteria, as they focus on the comparability of situations to determine unequal treatment, followed by an analysis of possible justifications. Therefore, the content of these assessments is notably similar. Nevertheless, the non-discrimination test under the fundamental freedoms cannot be directly applied to State aid law, as it, like the selectivity test, has its own inherent weaknesses. Instead, a modified form, as outlined in the previous chapter (in particular Chapter 5.5.), can and should be integrated into State aid law.

The tool of State aid is to tackle regulatory and market failure but should not be used to correct the tax systems of MS or sanction the exploitation of loopholes created by diverging tax systems. State aid is not designed to catch the cross-border dynamics created by BEPS. The State aid rules do not and cannot replace the need for more coordination among the tax policies of MS to reduce and eliminate harmful tax competition. In the end, direct taxes are a MS competence and political field which must allow for some discretion rather than be based on a purely theoretical framework. State aid rules should not require perfect national tax laws, but MS are and should be allowed to make comprehensible and justified differentiations. It is, therefore, essential for the MS and the EU institutions to decide on how to strike a balance between harmonisation and tax competition.

In recent years, it has become apparent that tolerance of over-enforcement has increased as the Commission explores the outer limits of its enforcement options. This includes extending or even overstretching the scope of provisions such as Art 107(1) TFEU in order to Europeanise national tax laws. What can be observed is a decrease in the law-driven enforcement and an increase in policy-based enforcement by the Commission. This can be seen from the number of guidelines and the number of preliminary rulings. It seems that clarifying the scope of application of competition and more specifically State aid law is no longer the Commission's priority. Rather, it can even be said that there is a tendency towards outcome-orientated enforcement, although the question arises as to whether this is good or bad, desirable or not. In the area of Art 107 TFEU, it is the governments of the MS that have to provide justifying arguments. Consequently, the prima facie suspicion by the Commission that tax differentiations are State aid relevant should be abandoned. Instead, it must sufficiently reason its decision that a measure introduces unequal treatment. Moreover, the assessment should open more towards taking into account permissible objectives by MS, which controlled regarding their compatibility within the proportionality assessment. Nevertheless, Pandora's box does not appear to be fully open as the European courts continue to curb the Commission's creative approach. The position of the GC in recent tax cases suggests that State aid rules are not the right instruments to solve the systematic problems of international taxation. Although it can be disputed whether State aid is the right tool for greater harmonisation in the area of direct taxation, in any case, a clearer line by the CJEU is required.

There is currently no one-size-fits-all solution. However, a clearer methodology for the assessment of direct tax cases under EU State aid law can be sought on the basis of an adapted selectivity test, as proposed in this thesis. The fact that generally a case-by-case assessment is employed is not an obstacle. On the contrary, a case-by-case assessment is actually the most organic approach. The proposed two-step test provides a framework for all the different possible tax aid cases and thus also a case-by-case approach through the application of uniform standards that can be applied to each of these cases. The future of fiscal State aid will remain just as dynamic as in previous years. It will also remain at least as much a political as a legal matter. Therefore, a way must finally be found to bring some stability to the topic.

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