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Layered Anti-Avoidance in EU Corporate Tax Law: CFC Rules, Substance and Global Minimum Taxation in Austria, Slovakia, Cyprus and Luxembourg

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List of Abbreviations

ACITA	Austrian Corporate Income Tax Act (Körperschaftsteuergesetz 1988, BGBl No 401/1988, as amended)
ATAD	Anti-Tax Avoidance Directive
BEAT	Base Erosion and Anti-Abuse Tax
BEPS	Base Erosion and Profit Shifting
CFC	Controlled Foreign Company
CITL	Cypriot Income Tax Law (Law 118(I)/2002)
CJEU	Court of Justice of the European Union
EEA	European Economic Area
ETR	Effective Tax rate
GAAR	General Anti-Avoidance Rule
GILTI	Global Intangible Low-Taxed Income
GloBE	Global Anti-Base Erosion
G20	Group of Twenty
IIR	Income Inclusion Rule
KStG	Körperschaftsteuergesetz 1988
LITL	Luxembourg Income Tax Law (Law of December 4, 1967, on Income Tax (as amended)
MNE	Multinational Enterprise
OECD	Organization for Economic Cooperation and Development
PE	Permanent Establishment
QDMTT	Qualified Domestic Minimum Top-up Tax
SBIE	Substance-based income exclusion
SITA	Slovak Income Tax Act (Act No. 595/2003 Coll., as amended)
TFEU	Treaty on the Functioning of the European Union
UTPR	Undertaxed Profits Rule

Introduction

The increasing globalisation of business activities and the growing mobility of capital have significantly intensified concerns regarding base erosion and profit shifting. In response, both the European Union and OECD have developed a range of anti-avoidance measures to protect national tax bases and ensuring a fair allocation of taxing rights. Among these measures, Controlled Foreign Company (CFC) rules have emerged as a key instrument aimed to prevent the artificial diversion of profits to low-tax jurisdictions. More recently, the OECD/G20 Pillar Two framework has introduced a global minimum effective tax rate of 15% for large multinational enterprise groups, adding a new dimension to the international anti-avoidance landscape. The adoption of Pillar Two represents one of the most significant developments in international taxation in recent decades. However, its introduction has also raised important questions regarding its relationship with existing anti-avoidance mechanisms, particularly CFC regimes. While both frameworks seek to address risks associated with low-taxed income and profit shifting, their coexistence has given rise to broader debates concerning their interaction, coherence and continued necessity within the evolving international tax landscape. At the same time, the role of economic substance remains an important consideration in applying anti-avoidance measures under EU law, adding a further layer of complexity to the assessment of these regimes.

In light of these developments, the present thesis examines the interaction between CFC regimes and the Pillar Two framework within the EU, with particular emphasis on the role of substance requirements and their significance within the broader anti-avoidance architecture. The analysis focuses on four selected jurisdictions: Austria, Slovakia, Cyprus and Luxembourg. These jurisdictions were selected because they provide diverse perspectives on the implementation and operation of CFC rules within the EU and enable a meaningful assessment of the interaction among domestic anti-avoidance regimes, substance requirements, and the Pillar Two framework. Austria is a jurisdiction with a relatively well-established CFC regime closely aligned with the Anti-Tax Avoidance Directive (ATAD) framework, while Luxembourg is an important case study of a traditional international holding and investment jurisdiction seeking to reconcile domestic anti-avoidance rules with evolving international tax standards. Cyprus offers the perspective of a low-tax Member State where questions concerning effective taxation and economic substance are particularly relevant. Finally, Slovakia illustrates the approach of a Central European Member State that has implemented the ATAD framework as part of a broader process of corporate tax modernisation. Together, these jurisdictions provide a suitable basis for examining both convergence and divergence in the application of substance-based anti-avoidance measures within the EU. The central research question guiding this analysis is:

How do CFC regimes in Austria, Slovakia, Cyprus and Luxembourg interact with Pillar Two and substance requirements and to what extent do they form a coherent and proportionate anti-avoidance framework in the post-Pillar Two environment?

In order to address this question, the thesis is structured around several secondary research questions.

First, it examines whether domestic substance carve-outs reflect a uniform EU concept of abuse in light of the jurisprudence of the Court of Justice of the European Union.

Second, it analyses how national thresholds for economic substance and control compare across the selected jurisdictions and whether these differences are compatible with EU primary law.

Third, it considers whether Pillar Two reduces, replaces or merely complements the anti-deferral function of CFC regimes, and how this affects their continued relevance.

Finally, it evaluates whether the coexistence of CFC rules and global minimum taxation results in regulatory duplication inconsistent with the EU's current objectives of simplification and competitiveness.

Based on these research questions, the thesis advances several academic hypotheses.

First, it is hypothesised that Pillar Two reduces the anti-deferral function of CFC rules but does not entirely eliminate their relevance as anti-abuse instruments.

Second, despite formal harmonisation under ATAD, Member States are expected to apply materially divergent substance thresholds in practice, which result in inconsistencies in the application of CFC regimes.

Third, it is proposed that certain national interpretations of substance and control may exceed the requirements of the uniform EU concept of abuse as developed by the CJEU.

Finally, the thesis hypothesises that the layered coexistence of CFC regimes and Pillar Two gives rise to partial regulatory redundancy, thereby calling into question the necessity and proportionality of maintaining parallel anti-avoidance mechanisms.

The thesis combines doctrinal legal research with a comparative analysis of national tax regimes. It examines relevant EU primary and secondary legislation, OECD materials, domestic legal frameworks and the jurisprudence of the Court of Justice of the European Union (CJEU). By bringing together EU law, international tax developments and national implementation practices, the study seeks to contribute to the ongoing academic and policy debate on the future of anti-avoidance measures within the EU. In particular, it assesses whether the current combination of traditional anti-abuse rules and minimum taxation constitutes a coherent and proportionate framework or whether further coordination, simplification and recalibration may be required in light of the changing landscape of international corporate taxation.

1. CFC Rules in the European and International Context

To understand the function and policy rationale of CFC rules within national tax systems, it is necessary to briefly consider the broader framework of international taxation and the allocation of taxing rights between source and residence jurisdictions. The foundations of this framework were developed during the first half of the 20th century through the work of the League of Nations and were subsequently refined and institutionalised by the OECD during the latter half of the century. For several decades, this framework has provided a relatively stable basis for the international tax system, although recent developments associated with the digitalisation of the global economy have begun to challenge its underlying assumptions.[1]

At the core of the traditional international tax architecture are several key principles governing the allocation of taxing powers. First, states are generally recognised as having the authority to levy taxes based either on the source of income or the taxpayer's residence.[2] Source-based taxation refers to income that arises or is generated within a particular jurisdiction, while residence-based taxation is justified by the taxpayer's personal and economic attachment to a specific state. Second, the jurisdiction in which the income originates, the source country, is

[1] B J Arnold, 'The Evolution of Controlled Foreign Corporation Rules and Beyond' (2019) 73(12) Bulletin for International Taxation, 631.
[2] OECD Model Convention, Commentary on Article 23, para 1–3.

typically granted the primary right to tax that income. This reflects the idea that the economic activity generating the income occurs within that jurisdiction. Third, the country of residence retains the right to tax the worldwide income of its residents. However, in order to avoid international double taxation, the residence state is generally expected to provide relief for foreign-source income already taxed in another jurisdiction, usually through tax credits or exemptions. Although early discussions of international taxation assumed that income should ideally be taxed "once and only once"[3], the so-called "single tax principle" historically received relatively limited attention. Instead, the primary objective of international tax coordination was the elimination of double taxation rather than the prevention of double non-taxation.[4] Only with the OECD/G20 Base Erosion and Profit Shifting (BEPS) Project did the issue of double non-taxation become a central concern of international tax policy; accordingly, the project may be understood primarily as an effort to address structural inconsistencies within the international tax architecture and the avoidance opportunities arising from them, rather than as an initiative aimed at implementing the single-tax principle. Consequently, it remains debatable whether the prevention of double non-taxation can truly be considered a traditional foundational principle of the international tax system or whether it has emerged only more recently through the BEPS reforms.[5]

In addition to these three fundamental principles, the international tax framework has traditionally been supplemented by several secondary principles. First, source states are generally permitted to tax passive income, such as dividends, interest, rents and royalties, through withholding taxes levied on gross payments. These withholding taxes are typically limited or reduced under bilateral tax treaties.[6] Second, business profits derived by a non-resident are usually taxable in the source state only when the taxpayer maintains a significant economic presence, typically through a permanent establishment (PE). In such cases, only the profits attributable to the PE are subject to taxation in the source state, and this taxation is usually imposed on a net basis.[7] Third, the international tax system traditionally emphasises the principle of non-discrimination, under which non-resident taxpayers conducting business in a

[3] League of Nations, *Report of the Committee of Experts on Double Taxation and Tax Evasion* p. 23 (League of Nations Publications 1927).
[4] H.J. Ault, *Some Reflections on the OECD and the Sources of International Tax Principles*, 70 Tax Notes Intl. 12, pp. 1195-1201 (2013).
[5] B J Arnold, 'The Evolution of Controlled Foreign Corporation Rules and Beyond' (2019) 73(12) Bulletin for International Taxation, 631–632.
[6] Arts. 6, 10, and 11 *OECD Model* (2017) and Arts. 6, 10-12 and 21 *UN Model* (2017).
[7] Art. 7 *OECD Model* (2017) and *UN Model* (2017), In accordance with Article 24 of the OECD Model (2017) and the UN Model (2017), the requirement to apply net-basis taxation to non-residents arises only where residents in comparable circumstances are taxed on a net basis.

jurisdiction should not be treated less favourably than comparable resident taxpayers. Similarly, resident companies controlled by foreign shareholders or making deductible payments to non-residents should not be subject to discriminatory taxation.[8] Fourth, residence jurisdictions generally treat foreign subsidiaries of domestic corporations as separate taxable entities, rather than attributing their income directly to the parent company. Correspondingly, subsidiaries located in a source state are not normally treated as PEs of their foreign parent companies. This approach reflects the widely recognised separate-entity principle.[9] While many deviations and exceptions have existed, the overall structure of international taxation largely adhered to these principles, at least until the implementation of the BEPS reforms. As a result, the international tax regime significantly reduced instances of double taxation, although it did not eliminate them entirely.[10]

Two further observations should be made regarding this framework. First, many of these principles effectively impose limitations on the taxation rights of source states, while the taxation powers of residence states remain comparatively broad, subject mainly to the obligation to relieve double taxation. This structural bias reflects the historical influence of capital-exporting developed economies in shaping international tax norms. Second, the stability of these principles has gradually weakened over time. Several countries have extended their source-based taxation rights beyond traditional business profits by imposing withholding taxes on payments for consulting, technical and management services provided by non-residents.[11]

Similarly, the threshold for establishing a PE has gradually been reduced through amendments to treaty provisions and interpretative commentary in both the OECD and UN Model Conventions. The principle that foreign subsidiaries should be treated as separate taxable entities has been progressively eroded since the United States introduced its CFC regime in 1962. These developments illustrate the growing tension between traditional international tax principles and modern anti-avoidance measures, including CFC rules.[12]

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[8] Art. 24 *OECD Model* (2017) and *UN Model* (2017).
[9] Art. 5(7) *OECD Model* (2017) and *UN Model* (2017).
[10] B J Arnold, 'The Evolution of Controlled Foreign Corporation Rules and Beyond' (2019) 73(12) Bulletin for International Taxation 631–632.
[11] B J Arnold, 'The Evolution of Controlled Foreign Corporation Rules and Beyond' (2019) 73(12) Bulletin for International Taxation, 631–632.
[12] B J Arnold, 'The Evolution of Controlled Foreign Corporation Rules and Beyond' (2019) 73(12) Bulletin for International Taxation, 633.

1.1. The Policy Rationale of CFC Rules

A defining characteristic of the current corporate environment is the extensive degree of global economic integration. This level of integration, together with pronounced differences in tax rates across jurisdictions, has created enhanced opportunities for tax planning and has significantly complicated the taxation of corporate income, as multinational enterprises frequently generate profits across multiple jurisdictions.[13] As a result, corporate taxation has increasingly become a cross-border policy issue. When a multinational group comprises a parent company and several subsidiaries located in different countries, the question arises of how the profits generated within this structure should be allocated and taxed. Under the prevailing approach in international tax law, each company within a multinational group is treated as a separate taxable entity. Consequently, the parent company is taxed according to the corporate tax rules applicable in its country of residence, while each subsidiary is taxed in the jurisdiction in which it is incorporated or operates. Nevertheless, because subsidiaries are owned by the parent company, the ultimate economic control over the profits generated within the group remains with the parent entity. The parent company, therefore, has the ability to decide whether and when these profits will be repatriated. To mitigate the risk of double taxation, many residence jurisdictions apply a participation exemption system to dividends received from foreign subsidiaries. Under such systems, profits distributed within the corporate group are typically exempt from additional taxation in the parent company's jurisdiction.[14]

In this respect, CFC rules represent a significant departure from the traditional separate entity principle that underpins international corporate taxation. Rather than treating the foreign subsidiary as an entirely independent taxpayer, CFC regimes permit certain categories of income earned by the subsidiary to be attributed directly to its controlling shareholder and taxed in the shareholder's state of residence. The rationale for this departure is the concern that the separate entity principle may otherwise facilitate the accumulation of low-taxed income in foreign entities without corresponding taxation at the parent company level. In this context, while the separate entity principle represents a fundamental element of international corporate taxation, it also creates opportunities for multinational enterprises to reduce their global tax burden. Where a parent company owns subsidiaries located in jurisdictions with comparatively

[13] S Clifford, 'Taxing Multinationals Beyond Borders: Financial and Locational Responses to CFC Rules' (2019) 173 *Journal of Public Economic,* 44.
[14] S Clifford, 'Taxing Multinationals Beyond Borders: Financial and Locational Responses to CFC Rules' (2019) 173 *Journal of Public Economic,* 44–45.

low corporate tax rates, it may shift part of its income to those subsidiaries and retain the profits within them. Such profit shifting strategies allow multinational groups to benefit from differences in national tax systems and to minimise their overall tax liability.[15] Consequently, these countries have a strong incentive to introduce measures that limit such practices and protect their domestic corporate tax base.[16]

One of the principal instruments developed to address this challenge is the introduction of controlled foreign corporation rules. CFC regimes allow the residence country of a parent company to impose tax on certain types of income earned by its foreign subsidiaries, thereby extending the reach of domestic corporate taxation beyond national borders. An illustrative example may be drawn from a multinational group structure in which a parent company is based in Germany, with subsidiaries established in Singapore and Canada. If the Singaporean subsidiary is subject to a significantly lower level of taxation than the Canadian subsidiary, German CFC legislation may attribute the Singaporean subsidiary's passive income to the German parent company and subject it to German taxation. By contrast, the income of the Canadian subsidiary may remain outside the scope of the German CFC regime because it is already taxed at a comparatively high rate in Canada.[17]

Although the specific design of CFC rules differs among jurisdictions, most regimes are structured around three core criteria: a control criterion, a tax-level criterion, and an income-type criterion. These elements together determine whether the income of a foreign subsidiary should be attributed to the parent company and taxed in the residence jurisdiction. In the first place, the control criterion generally requires that the resident shareholder exercise sufficient level of control over the foreign subsidiary. This requirement ensures that the parent company has the ability to influence the subsidiary's financial decisions and, therefore, potentially use the corporate structure to shift income for tax purposes. In many jurisdictions, this condition is satisfied when the parent company holds a majority of the voting rights or possesses substantial economic rights, such as entitlement to profits upon distribution. The tax-level criterion focuses on the tax rate applied to the foreign subsidiary. Since profit-shifting strategies typically involve relocating income to jurisdictions with lower tax rates, CFC regimes usually target subsidiaries subject to a level of taxation significantly below that of the parent company's jurisdiction. In

[15] M Rechbauer, S Rünger and B Sieghartsleitner, 'How Effective Are CFC Rules in Containing Tax Haven Activities? Evidence from a Sample of European Firms' (2025) 17(1) *World Tax Journal,* 141–142.
[16] S Clifford, 'Taxing Multinationals Beyond Borders: Financial and Locational Responses to CFC Rules' (2019) 173 *Journal of Public Economic,* 46–47.
[17] S Clifford, 'Taxing Multinationals Beyond Borders: Financial and Locational Responses to CFC Rules' (2019) 173 *Journal of Public Economics*, 46.

practice, this threshold may be defined either as a specific minimum tax rate or as a proportion of the tax that would have been payable had the income been taxed in the residence country. The third element concerns the nature or source of the income earned by the foreign subsidiary. Most CFC regimes primarily target passive income, often referred to as tainted income, which typically includes interest, royalties, portfolio investment income and certain types of rental income. These forms of income are considered particularly mobile and, therefore, more susceptible to profit-shifting strategies. By contrast, income generated from genuine commercial activities, such as the sale of goods or services, is often excluded from the scope of CFC rules in order to avoid interfering with legitimate international business operations. Where all three criteria are satisfied, the passive income earned by the foreign subsidiary is attributed to the parent company and included in its taxable income. Importantly, this taxation generally occurs on an accrual basis, meaning that the income is taxed in the residence jurisdiction as it is earned by the subsidiary rather than when it is eventually distributed to the parent company. As a result, the tax advantage associated with retaining passive income in low-tax jurisdictions is effectively eliminated.[18]

1.2 CFC Rules in a Multi-Level Framework: BEPS and ATAD

Controlled foreign company legislation represents an important policy instrument used by states to counteract the effects of harmful tax regimes operating in other jurisdictions. Historically, CFC regimes have existed for almost six decades, beginning with their incorporation into the US international tax system, known as Subpart F in 1962,[19] and were subsequently adopted by other capital-exporting countries in the following decades. Canada and Germany implemented CFC regimes in 1972, followed by further developments in the late 1970s and early 1980s, when Japan (1978), France (1980) and the United Kingdom (1984) introduced similar legislation. While the spread of these rules was initially gradual, a clear expansion occurred from the 1990s onwards, with most developed economies and several major developing countries implementing CFC regimes. Within the European Union, this trend culminated in the mandatory adoption of CFC rules by all Member States under the ATAD, effective from 2019. The widespread implementation of CFC rules reflects their perceived

[18] S Clifford, 'Taxing Multinationals Beyond Borders: Financial and Locational Responses to CFC Rules' (2019) 173 *Journal of Public Economics* 41–46.

[19] M Rechbauer, S Rünger and B Sieghartsleitner, 'How Effective Are CFC Rules in Containing Tax Haven Activities? Evidence from a Sample of European Firms' (2025) 17(1) *World Tax Journal*, 141.

importance as a tool for protecting domestic tax bases against profit shifting. Although they are often associated with large multinational enterprises, their function extends more broadly to preventing tax avoidance through the use of foreign entities by both corporations and individuals. At the same time, the effectiveness of CFC rules cannot be assessed solely by their widespread adoption. Rather, their impact depends significantly on their specific design and scope, which vary considerably across jurisdictions.[20]

By 1998, several countries had already introduced CFC rules, and the OECD's Harmful Tax Competition Report further promoted their use as a tool against harmful tax practices. But the OECD's Harmful Tax Competition Report primarily focused on preferential tax regimes considered harmful, both within OECD member states and in non-member jurisdictions, while recognising that low or zero tax rates alone do not necessarily constitute abusive practices. The implementation of the Report led to the creation of institutional mechanisms, including the Forum on Harmful Tax Practices and a peer-review system to identify and monitor the elimination of such regimes. While these initiatives contributed to limiting preferential regimes, tax competition did not disappear but instead, jurisdictions have increasingly shifted their strategies for attracting investment, placing greater emphasis on competition on general corporate tax rates. This trend has intensified over time, highlighting the limitations of existing anti-avoidance measures, including CFC rules.[21]

Another important development concerns the growing emphasis on value creation in international tax law, particularly following Actions 8–10 of the OECD/G20 BEPS Project. These reforms sought to align the allocation of profits with the location of economic activities and value-creating functions.[22] In principle, value creation is intended to capture both the contribution of a taxpayer's activities to the overall profitability of a multinational enterprise and the role played by the economic environment, including public goods provided by the state. Within the BEPS framework, the concept has served as an important tool for limiting the ability of low-tax jurisdictions to claim taxing rights over profits that are not supported by substantive economic activity, effectively functioning as a form of negative allocation rule. However, the practical application of value creation raises significant challenges. In particular, allocating taxing rights based on this concept is difficult in a competitive international environment where

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[20] B J Arnold, 'The Evolution of Controlled Foreign Corporation Rules and Beyond' (2019) 73(12) Bulletin for International Taxation, 638.

[21] B J Arnold, 'The Evolution of Controlled Foreign Corporation Rules and Beyond' (2019) 73(12) Bulletin for International Taxation, 638.

[22] B J Arnold, 'The Evolution of Controlled Foreign Corporation Rules and Beyond' (2019) 73(12) Bulletin for International Taxation, 638–639.

multiple jurisdictions can claim that economic activity occurs within their territory. Academic commentary has also questioned the strength of the link between economic activity and value creation, suggesting that this relationship is often uncertain or overstated. Moreover, the concept tends to favour jurisdictions where high-value functions such as strategic decision-making, branding, research and development, and marketing are performed, typically located in higher-income countries. As a result, the value creation paradigm may systematically allocate a greater share of profits to such jurisdictions.[23]

While the BEPS reforms aim to align profit allocation with the location of economic activities, the introduction of the DEMPE framework (development, enhancement, maintenance, protection and exploitation of intangibles) does not fully prevent profits from being shifted to low-tax jurisdictions. Although the reforms restrict the use of purely contractual arrangements lacking economic substance, they do not preclude structuring activities to satisfy the formal requirements of value creation while still achieving tax advantages. The emphasis on value creation within the BEPS framework can be understood as a redefinition of the concept of source, requiring that taxation be aligned with genuine income-generating activities supported by economic substance. At the same time, the concept serves a dual function: it guides the allocation of profits and acts as a tool to counter tax avoidance.[24] Nevertheless, the assumption that value creation alone can resolve the structural weaknesses of the international tax system has been subject to criticism. Several commentators have therefore questioned whether the value creation paradigm is capable of addressing profit shifting beyond the transfer pricing context. While the OECD's work contributed to the broader policy debate and the identification of harmful tax practices, it did not fully harmonise CFC regimes or eliminate tax competition, particularly regarding corporate tax rates.[25]

Similarly, the work conducted under BEPS Action 3[26] introduced recommendations for the design of effective CFC regimes.[27] However, the Final Report on Action 3 did not establish

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[23] GW Kofler and I Verlinden, 'Unlimited Adjustments: Some Reflections on Transfer Pricing, General Anti-Avoidance and Controlled Foreign Company Rules, and the "Saving Clause"' (2020) 74(4/5) *Bulletin for International Taxation,* 271.

[24] GW Kofler and I Verlinden, 'Unlimited Adjustments: Some Reflections on Transfer Pricing, General Anti-Avoidance and Controlled Foreign Company Rules, and the "Saving Clause"' (2020) 74(4/5) *Bulletin for International Taxation,* 271.

[25] B J Arnold, 'The Evolution of Controlled Foreign Corporation Rules and Beyond' (2019) 73(12) Bulletin for International Taxation, 638–639.

[26] OECD, *Action 3 Final Report* (2015), *supra* n. 3..

[27] GW Kofler and I Verlinden, 'Unlimited Adjustments: Some Reflections on Transfer Pricing, General Anti-Avoidance and Controlled Foreign Company Rules, and the "Saving Clause"' (2020) 74(4/5) *Bulletin for International Taxation,* 272.

the adoption of CFC rules as a minimum standard, nor did it explicitly require or strongly encourage jurisdictions to implement such rules. Instead, it provided a flexible framework, leaving significant discretion to individual countries. The report focuses on three key elements that determine the scope of CFC regimes: the types of foreign entities covered by the rules, the level of foreign taxation applied to the income of those entities and the categories of income that should be attributed to resident shareholders With respect to the definition of control, the report recommends that CFC rules should apply where a sufficient degree of legal or economic control exists over a foreign entity, while leaving considerable discretion to jurisdictions regarding the precise thresholds and design of the control test. Still, the report does not address the interaction between CFC rules and the taxation of dividends from foreign subsidiaries, despite the importance of this issue for the overall coherence of the tax system. Regarding the level of foreign taxation, the report recommends limiting the application of CFC rules to situations in which the foreign entity's income is subject to a relatively low tax rate. In practice, this approach is often implemented through jurisdictional or "listed-country" systems, under which CFC rules target entities resident in low-tax jurisdictions. This reflects the general policy objective of focusing CFC regimes on cases where profit shifting is most likely to occur. However, the report provides only limited guidance on the most critical aspect of CFC rules, namely: the definition of income subject to attribution. While it suggests that attributable income should include income giving rise to BEPS concerns, it ultimately leaves the determination of such income to national legislators. The report outlines a range of possible approaches, from broad inclusion of all income earned by a CFC to narrower models targeting only specific types of passive or highly mobile income, such as returns generated by low-function financing entities. Overall, the Final Report on Action 3 has been criticised for its lack of prescriptive guidance and limited practical impact. In contrast to other components of the BEPS Project, it neither established binding standards nor provided a coherent framework for designing of effective CFC regimes. As a result, significant differences persist across jurisdictions, and the report has done little to harmonise national approaches to CFC legislation.[28] The limited harmonising effect of BEPS Action 3 partly explains why the European Union subsequently adopted a more prescriptive approach through ATAD.

[28] B J Arnold, 'The Evolution of Controlled Foreign Corporation Rules and Beyond' (2019) 73(12) Bulletin for International Taxation, 639–640.

Following the OECD's recommendations, the European Union adopted Directive (EU) 2016/1164 (ATAD)[29], which required Member States to introduce and adapt a range of anti-avoidance measures, including CFC rules, by the end of 2018 and establish a common minimum standard. Although several jurisdictions had already implemented CFC regimes unilaterally, the Directive marked an important step toward their coordinated application across the EU. ATAD sought to achieve a degree of harmonisation, while still allowing Member States discretion in implementation, particularly through the choice between two alternative approaches[30], which differ in their scope and applicable exemptions. Under the first approach – Model A, the Directive allows an exclusion where the foreign entity carries on substantive economic activity supported by staff, assets, equipment and premises. Under Model B, the focus is on non-genuine arrangements put in place solely to obtain a tax advantage. In both cases, the design of the regime shows an effort to align EU secondary legislation with the limits derived from primary law and the CJEU's abuse jurisprudence.[31] Despite the ATAD's framework overarching objective of discouraging profit shifting, the presence of exemptions means CFC rules do not fully eliminate planning opportunities for multinational enterprises.[32]

Under ATAD, CFC rules must apply to foreign entities and to foreign PEs, where two cumulative conditions are met.[33] First, the entity must be controlled, directly or indirectly, by a resident taxpayer, either alone or together with associated enterprises. Second, the foreign entity must be subject to a level of taxation that is significantly lower than that which would have applied in the residence jurisdiction. In practice, this threshold is generally interpreted as applying where the foreign tax burden amounts to less than 50 % of the tax that would have been payable in the Member State of the controlling shareholder.[34]

Despite the harmonising objective of ATAD, significant discretion remains at the level of national implementation. As a result, important differences continue to exist among Member States regarding the scope and operation of their CFC regimes. These variations can be observed, for example, in the level of ownership required to trigger the application of CFC rules, the methods used to identify low-tax jurisdictions, and the availability of exemptions.

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[29] 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.
[30] Commonly referred to as Model A and Model B.
[31] Monique T Malan, 'The De Minimis Exclusions in the ATAD's CFC Rules: A Normative Analysis' (2024) 52(12) *Intertax*, 798–800.
[32] Emilia Gschossmann and Alina Pfrang, 'Multinationals' Location, Financial and Real Responses to the EU-Wide Implementation of CFC Rules by the ATAD' (University of Mannheim, working paper, 14 May 2024), 31.
[33] Art. 7(1) ATAD.
[34] B J Arnold, 'The Evolution of Controlled Foreign Corporation Rules and Beyond' (2019) 73(12) Bulletin for International Taxation, 640.

Some countries determine whether a subsidiary is low-taxed by comparing its effective tax burden with the domestic tax rate, while others rely on blacklists of jurisdictions considered to have harmful tax regimes. Such differences may have implications for both the effectiveness of CFC rules and the competitive position of individual jurisdictions. If CFC regimes are significantly more restrictive in one country than in another, multinational enterprises may prefer to locate their parent companies or investments in jurisdictions with more lenient rules. Consequently, while ATAD has significantly increased the level of coordination within the European Union, substantial differences between national CFC regimes persist.[35]

Taken together, these developments demonstrate the gradual evolution of CFC rules from a relatively controversial departure from the separate entity principle into a widely accepted component of the international tax system. Through the OECD's work on harmful tax practices, the recommendations developed under BEPS Action 3 and the subsequent adoption of ATAD, CFC regimes have become an established instrument for addressing profit shifting and protecting domestic tax bases. Nevertheless, significant differences between national regimes have persisted, and concerns have remained as to whether traditional anti-deferral mechanisms are capable of addressing all forms of low-taxed income within increasingly complex multinational group structures. These developments ultimately contributed to a broader re-evaluation of the international tax framework and paved the way for the emergence of the OECD/G20 Two-Pillar Solution. In particular, Pillar Two represents a further step in the evolution of international anti-avoidance policy by shifting the focus from the attribution of specific categories of income towards ensuring a minimum level of effective taxation on a jurisdictional basis. [36]

1.3 Designing CFC Rules under the EU Law: Primary Law Limitations

While the compatibility of CFC rules with EU primary law has long been debated, this issue remains highly relevant in the post-BEPS and Pillar Two environment. EU primary law imposes significant constraints on the design of CFC rules within Member States. Due to their structure and objective, CFC rules inherently entail a restriction of either the freedom of

[35] M Rechbauer, S Rünger and B Sieghartsleitner, 'How Effective Are CFC Rules in Containing Tax Haven Activities? Evidence from a Sample of European Firms' (2025) 17(1) *World Tax Journal,* 141.
[36] B J Arnold, 'The Evolution of Controlled Foreign Corporation Rules and Beyond' (2019) 73(12) Bulletin for International Taxation, 642.

establishment[37] or the free movement of capital[38]. In practice, CFC regimes are primarily assessed under the freedom of establishment, as they generally apply to situations involving a controlling interest in a foreign entity. The free movement of capital may nevertheless become relevant in certain third-country situations where the criterion of control is less decisive. [39]

Most notably, the jurisprudence of the Court of Justice of the European Union, in *Cadbury Schweppes* (C-196/04)[40], has clarified that such rules may constitute a restriction on the freedom of establishment and can only be justified where they specifically target wholly artificial arrangements. This limitation reflects the broader principle of proportionality developed by the CJEU, according to which anti-avoidance measures may not rest on a general presumption of tax avoidance but must allow taxpayers to demonstrate the existence of genuine economic activity.[41]

Several provisions of the ATAD relating to controlled foreign company rules have raised concerns regarding their compatibility with the fundamental freedoms of EU primary law. These rules may result in less favourable treatment of cross-border situations compared to purely domestic ones, thereby potentially restricting the freedom of establishment. Importantly, the fact that such rules are introduced through EU secondary legislation does not shield them from review under primary law. Since ATAD represents only a form of minimum harmonisation and leaves Member States with discretion in implementation, both the Directive itself and national measures adopted under it remain subject to scrutiny under EU primary law. As noted above, in line with the judgment in *Cadbury Schweppes*, CFC rules are permissible only insofar as they specifically target wholly artificial arrangements. ATAD reflects this requirement by introducing an exception for entities engaged in substantive economic activity. However, the Directive allows Member States to refrain from applying this exception to entities established in third countries, raising concerns about unequal treatment and potential incompatibility with EU law, particularly in light of subsequent case law extending similar protections to certain third-country situations.[42] The availability and scope of such substance-based exceptions therefore play a crucial role in determining whether national CFC regimes

[37] Art. 49 TFEU.
[38] Art. 63 TFEU.
[39] Monique T Malan, 'The De Minimis Exclusions in the ATAD's CFC Rules: A Normative Analysis' (2024) 52(12) *Intertax*, 794.
[40] *Case C-196/04 Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue* EU:C:2006:544.
[41] S Schenkelberg, 'The Cadbury Schweppes Judgment and Its Implications on Profit Shifting Activities within Europe' (2020) 27(1) *International Tax and Public Finance*, 1–2.
[42] W Haslehner and K Pantazatou, *Assessment of Recent Anti-Tax Avoidance and Evasion Measures (ATAD & DAC 6)* (European Parliament, 2022), 13–16.

remain within the limits imposed by EU primary law. Overall, while ATAD attempts to align CFC rules with the limits established by the CJEU, questions remain as to whether all of its design features fully comply with EU primary law.[43] A particularly sensitive point is the possibility that, under Model A, Member States may not extend the substance carve-out to certain third-country entities. In light of the Court's later case law on third-country situations, this differential treatment may be difficult to justify where adequate mechanisms for the exchange of information exist. For that reason, the compatibility of national CFC implementation with EU primary law still depends not only on the wording of ATAD, but also on how Member States transpose and apply it in practice.[44]

Recent case law further confirms that the implementation of CFC rules under the ATAD remains subject to strict scrutiny under EU law. In particular, the Court of Justice of the European Union has clarified that Member States must transpose ATAD provisions in a manner that not only addresses tax avoidance, but also respects the overall coherence of the internal market. In *Commission v Belgium* (C-524/23)[45], the Court found that Belgium had failed to correctly implement certain aspects of the ATAD CFC regime, as its legislation did not provide adequate relief for foreign taxes paid at the level of the controlled entity. This omission resulted in a risk of economic double taxation, which was considered incompatible with the requirements of the Directive. The judgment demonstrates that compliance with ATAD cannot be assessed in purely formal terms. Even where national rules are intended to follow the Directive, they must ensure that the allocation of taxing rights does not lead to disproportionate outcomes, such as double taxation, and that the balance between anti-avoidance objectives and fundamental principles of EU law is maintained. Accordingly, the case illustrates that the design and application of CFC rules in the EU remain closely constrained not only by secondary legislation, but also by broader principles of EU law.[46]

Moreover, despite the harmonising ambitions of ATAD, significant differences persist in the interpretation and application of CFC rules across Member States. The discretion left by the Directive, combined with the evolving jurisprudence of the CJEU, has resulted in varying approaches to concepts such as control, low taxation and economic substance. These

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[43] W Haslehner and K Pantazatou, *Assessment of Recent Anti-Tax Avoidance and Evasion Measures (ATAD & DAC 6)* (European Parliament, 2022), 13–16.
[44] Monique T Malan, 'The De Minimis Exclusions in the ATAD's CFC Rules: A Normative Analysis' (2024) 52(12) *Intertax*, 798–800.
[45] *Case C-524/23 Commission v Belgium* (judgment of 26 February 2026).
[46] A Smeets, 'European Court of Justice rules Belgium's initial CFC regime not in line with ATAD' (EY, 2026) https://www.ey.com/en_be/technical/tax/tax-alerts/2026/european-court-of-justice-rules-belgiums-initial-cfc-regime-not-in-line-with-atad accessed 7 April 2026

differences demonstrate that the effectiveness of CFC regimes cannot be assessed solely from a domestic anti-avoidance perspective. Rather, their design and application must remain consistent with the broader constitutional framework of the European Union, including the principles of proportionality, legal certainty and non-discrimination.[47]

These constraints have had a profound impact on the evolution of CFC rules within the European Union. Unlike traditional anti-deferral regimes applied in some non-EU jurisdictions, EU CFC rules cannot be designed solely by reference to tax policy objectives. Instead, they must operate within the limits imposed by the fundamental freedoms and the CJEU's concept of abuse. As a consequence, the notion of economic substance has become a central element in assessing both the legality and effectiveness of CFC regimes. The development of this concept and its role within the EU anti-avoidance framework are examined in the following chapter.

2. The Substance Requirement and the EU Concept of Abuse

The concept of economic substance occupies a central position in the assessment of abusive tax arrangements under EU tax law. In the context of CFC regimes, it serves as the principal criterion for distinguishing between wholly artificial arrangements and structures reflecting genuine economic activity. As such, the substance requirement represents a key link between the EU law concept of abuse, the design of CFC rules under the ATAD and the broader debate on the effectiveness and proportionality of anti-avoidance measures. Building on the EU principle of prohibition of abuse, the substance requirement operates as a doctrinal benchmark for evaluating whether cross-border structures fall within the permissible scope of tax planning.[48]

Recent developments in EU secondary law, particularly under the ATAD, indicate an attempt to translate the anti-abuse principle into concrete legislative standards. As previously outlined, the ATAD provides two alternative models for the design of CFC rules, namely the categorical and the transactional approach. These models differ not only in their conceptual framework and formulation but also in their respective scope of application and may be

[47] W Haslehner and K Pantazatou, *Assessment of Recent Anti-Tax Avoidance and Evasion Measures (ATAD & DAC 6)* (European Parliament, 2022) https://www.europarl.europa.eu/RegData/etudes/STUD/2022/703353/IPOL_STU(2022)703353_EN.pdf accessed 25 April 2026.

[48] Monique T Malan, 'The De Minimis Exclusions in the ATAD's CFC Rules: A Normative Analysis' (2024) 52(12) *Intertax*, 798–800.

implemented either separately or in combination. To ensure consistency with EU primary law requirements governing anti-avoidance measures, both approaches incorporate specific mechanisms aimed at identifying arrangements lacking economic substance. While the categorical approach achieves this through a substance-based carve-out, the transactional approach relies on a functional analysis of the allocation of functions and risks to assess whether the arrangement reflects economic reality. Consequently, the interpretation of this carve-out cannot be detached from the jurisprudence of the Court of Justice of the European Union, which delineates the permissible limits of national anti-avoidance measures. [49]

2.1 The Cadbury Schweppes Doctrine and the "Wholly Artificial Arrangement" Test

CFC regimes, by their nature, apply exclusively in cross-border situations and therefore inherently interfere with either the freedom of establishment. As a result, their application must be carefully balanced against these fundamental freedoms. *Cadbury Schweppes* confirmed that CFC rules may constitute a restriction on the freedom of establishment and therefore require adequate justification but crucially, the Court clarified that such justification cannot be based solely on the existence of a more favourable tax regime in another Member State. EU law guarantees the right of taxpayers to establish themselves in jurisdictions offering more advantageous tax conditions, and the mere loss of tax revenue does not constitute a legitimate ground for restricting this freedom. Accordingly, Member States are not entitled to neutralise tax advantages arising from lower taxation in another jurisdiction by imposing additional taxation on the shareholders of foreign entities. Instead, the CJEU has consistently held that CFC rules may only be justified where they target arrangements that are wholly artificial and designed to circumvent the tax normally due in the taxpayer's state of residence. Where, on the basis of objective and verifiable factors, it can be demonstrated that a foreign entity is genuinely established and carries out real economic activities in its host state, the application of CFC rules is not permissible. In such cases, the arrangement must be regarded as reflecting economic reality rather than constituting an abusive structure. This principle effectively establishes a doctrinal limit: CFC taxation within the EU must be confined to situations involving artificial arrangements lacking genuine economic substance. Importantly, the Court did not establish

[49] Marjaana Helminen, 'Threshold for the ATAD CFC Provision Substance Carve-Out to Apply: Significant, Substantive, Genuine or Real Economic Activities?' (2025) 65(7) *European Taxation,* 314.

substance as an autonomous tax policy objective. Rather, indicators such as staff, premises and equipment serve as evidence, enabling national authorities to determine whether an arrangement reflects economic reality or constitutes a wholly artificial arrangement.[50] The substance requirement therefore, derives from the broader EU law concept of abuse rather than existing as an independent legal standard. At the same time, taxpayers must be afforded the opportunity to demonstrate that their cross-border structures are supported by legitimate business reasons and correspond to actual economic activity. While Member States may require such proof, this obligation must not impose disproportionate administrative burdens. Importantly, this jurisprudence also has implications for interpreting the substance carve-out under the ATAD. Given that the carve-out was introduced precisely to ensure compliance with EU primary law, it must be interpreted consistently with the case-law-developed standard. This suggests that the relevant threshold is not one of “significant” or “substantial” activity, but rather the existence of genuine economic activity. The distinction between genuine, substantive and significant economic activity is explored in greater detail later in the thesis. In other words, even economic activity that is limited in scale may fall outside the scope of CFC rules, provided that it reflects economic reality and is not purely artificial. Finally, although the freedom of establishment applies primarily within the EU and the European Economic Area, similar considerations may arise under the free movement of capital in relation to third countries. Where Member States choose to apply the substance carve-out uniformly to both EU and non-EU entities, the interpretation of this concept should remain consistent. In such cases, the underlying principles derived from EU primary law continue to inform the meaning and scope of the substance requirement.[51]

2.2 Implementation models of the Substance Requirement under ATAD

As already outlined in the previous chapters, the ATAD establishes a minimum harmonisation framework for the design of CFC regimes within EU Member States. In this regard, Article 7 ATAD defines both the conditions under which foreign entities qualify as controlled foreign companies and the categories of income to be included in the tax base, while Article 8 sets out the corresponding tax consequences. Importantly, the Directive does not

[50] Opinion of AG Léger in Case C-196/04 *Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue* EU:C:2006:278.
[51] Marjaana Helminen, ‘Threshold for the ATAD CFC Provision Substance Carve-Out to Apply: Significant, Substantive, Genuine or Real Economic Activities?’ (2025) 65(7) *European Taxation,* 316.

prevent Member States from adopting stricter domestic or treaty-based measures aimed at ensuring a higher level of protection of their corporate tax bases. Within this framework, Article 7(2) ATAD provides Member States with two alternative methods for determining the income to be attributed under CFC rules.[52] Although both methods, the categorical and transactional approach, are conceptually distinct, they share certain core elements, in particular the criteria relating to control and low taxation, generally reflected in a low-tax threshold based on a comparison with the tax that would have been payable in the Member State of the controlling taxpayer. Beyond these common features, however, the two models diverge considerably in both their scope of application and their underlying conceptual design.[53] The first approach is based on predefined income categories, whereas the second focuses on profits derived from non-genuine arrangements. Under the category-based approach, Article 7(2)(a) ATAD specifies the types of undistributed passive income that must be included in the CFC tax base.[54]

Nevertheless, Member States retain the discretion to broaden the scope of income covered by their CFC regimes by including additional categories of income in line with their domestic tax policy objectives, as the ATAD establishes only a minimum level of harmonisation under Article 3 ATAD. The list of relevant income categories typically covers, inter alia, interest and other returns from financial assets; royalties and income derived from intellectual property, dividends and gains from the disposal of shares, as well as income from financial leasing, insurance, banking, and comparable financial activities. It also extends to income generated by so-called invoicing companies, which derive revenue from transactions with associated enterprises while adding little or no economic value. Where the conditions of the categorical approach are fulfilled, such income is included in the tax base of the controlling company to the extent that it is attributable to it. This inclusion generally applies irrespective of whether the underlying arrangement is driven by genuine commercial considerations or primarily tax-motivated purposes. In this sense, the categorical approach may be understood as a standardised or rule-based anti-abuse mechanism.[55]

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[52] Marjaana Helminen, 'Threshold for the ATAD CFC Provision Substance Carve-Out to Apply: Significant, Substantive, Genuine or Real Economic Activities?' (2025) 65(7) *European Taxation,* 314–315.
[53] Stefanie Geringer, 'Substance Test and Function-Risk Analysis in the ATAD's CFC Rule as Two Sides of the Same Coin: Strengths and Limits of a Uniform Concept of Abuse' (2023) 60(1) *Common Market Law Review*, 152.
[54] Marjaana Helminen, 'Threshold for the ATAD CFC Provision Substance Carve-Out to Apply: Significant, Substantive, Genuine or Real Economic Activities?' (2025) 65(7) *European Taxation,* 314.
[55] Stefanie Geringer, 'Substance Carve-Out and Function-Risk Analysis in the ATAD's CFC Rule as Two Sides of the Same Coin: Strengths and Limits of a Uniform Concept of Abuse' (2023) 60(1) *Common Market Law Review*, 152.

In order to ensure compliance with the fundamental freedoms enshrined in the TFEU, this approach is complemented by a substance carve-out. This carve-out limits the application of CFC rules within the European Union to situations where the controlled entity does not carry out substantive economic activity. Consequently, where a CFC demonstrates genuine economic activity supported by appropriate staff, assets, equipment and premises, it should fall outside the scope of CFC taxation. However, the application of this substance-based exemption varies by location of the entity. While it is mandatory for entities established within the European Economic Area (EEA), Member States retain discretion as to whether to extend this carve-out to entities located in third countries. As a result, entities established within the EEA that meet the substance requirements must be excluded from CFC taxation, and Member States are not permitted to impose stricter thresholds than those set out in the Directive.[56]

Alternatively, Member States may rely on the second model provided by Article 7(2)(b), which is based on the concept of non-genuine arrangements. Under this approach, the income included in the tax base is limited to non-distributed profits arising from arrangements put in place primarily to obtain a tax advantage.[57] By contrast, the transactional approach applies to all types of income, encompassing both active and passive categories. Its focus lies on assessing the genuineness of specific arrangements, or series thereof, typically by reference to a purpose-based test. Under this model, the application of CFC rules is conditional upon a finding that the essential purpose of the arrangement is to obtain a tax advantage. Furthermore, unlike the categorical approach, it permits the inclusion of undistributed income only to the extent that such income arises from non-genuine arrangements. The determination of non-genuineness is based on an analysis of functions and risks, examining whether the entity in question genuinely performs the relevant activities and assumes the associated risks. In particular, an arrangement is regarded as non-genuine where the entity would not have owned the assets or borne the risks generating its income in the absence of control by another group entity carrying out the significant people functions related to those assets and risks. This reliance on a function–risk assessment demonstrates that the transactional approach is closely aligned with principles developed in transfer pricing, especially those governing the allocation of income between associated enterprises and between head offices and PE.[58]

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[56] Marjaana Helminen, 'Threshold for the ATAD CFC Provision Substance Carve-Out to Apply: Significant, Substantive, Genuine or Real Economic Activities?' (2025) 65(7) *European Taxation,* 314–318.

[57] Marjaana Helminen, 'Threshold for the ATAD CFC Provision Substance Carve-Out to Apply: Significant, Substantive, Genuine or Real Economic Activities?' (2025) 65(7) *European Taxation,* 314–318.

[58] Stefanie Geringer, 'Substance Carve-Out and Function-Risk Analysis in the ATAD's CFC Rule as Two Sides of the Same Coin: Strengths and Limits of a Uniform Concept of Abuse' (2023) 60(1) *Common Market Law Review*, 152–153.

Given that the transactional approach is inherently based on a purpose-oriented assessment combined with a function–risk analysis, it does not require an additional, separate abuse test. By contrast, the categorical approach must be complemented by a substance carve-out in order to ensure its compatibility with EU primary law. Under this approach, CFC rules do not apply where the controlled entity carries on substantive economic activity supported by adequate staff, assets, and operational capacity. This highlights a key distinction between the two models: while the transactional approach evaluates the genuineness of specific arrangements, the categorical approach focuses on the substance of the entity as a whole. These conceptual differences are also reflected in the design of their respective exemptions. Under the categorical approach, Member States may exclude entities where only a limited proportion of income falls within the specified categories, including certain financial undertakings. In contrast, the transactional approach allows for the introduction of de minimis thresholds based on accounting profits, non-trading income, or the relationship between profits and operating costs.[59]

Although both ATAD models seek to address profit shifting through controlled foreign entities, they do so through different mechanisms. The categorical approach relies primarily on predefined income categories combined with a substance-based exemption, whereas the transactional approach focuses on the identification of non-genuine arrangements through a functional analysis. These differences raise important questions regarding the meaning and threshold of economic substance, which remain central to the interpretation of both models.

2.3 The Threshold of Economic Activity: Substantive, Significant and Genuine Economic Activity and CJEU case law

A central issue in the interpretation of the ATAD CFC rules concerns the threshold of economic activity required to fall outside their scope. While the Directive refers to "substantive" economic activity, the case law of the CJEU consistently uses the concept of genuine economic activity. This divergence has given rise to a debate as to whether the ATAD introduces a stricter standard than that required under EU primary law.[60] From a doctrinal

[59] Stefanie Geringer, 'Substance Carve-Out and Function-Risk Analysis in the ATAD's CFC Rule as Two Sides of the Same Coin: Strengths and Limits of a Uniform Concept of Abuse' (2023) 60(1) *Common Market Law Review*, 153–154.
[60] Marjaana Helminen, 'Threshold for the ATAD CFC Provision Substance Carve-Out to Apply: Significant, Substantive, Genuine or Real Economic Activities?' (2025) 65(7) *European Taxation,* 314–318.

perspective, the threshold must be interpreted in light of the fundamental freedoms and the principles established in *Cadbury Schweppes*. As the Court has made clear, CFC rules may not apply where an arrangement corresponds to economic reality, even if it is motivated by tax considerations.[61] It follows that the relevant test is not whether the activity is “significant” or “substantial” in a quantitative sense, but whether it is genuine.[62]

A comparison of the relevant formulations suggests that the substance carve-out is closely modelled on the substance test developed by the Court in *Cadbury Schweppes*. In that judgment, the assessment of whether an arrangement is artificial must be based on objective and verifiable criteria, in particular, the extent to which the controlled entity demonstrates a real physical presence, such as through premises, staff, and equipment. The Court’s approach appears to focus primarily on these tangible indicators of economic activity. This is noteworthy, as Advocate General Léger[63] additionally emphasised factors such as the expertise of personnel and the actual contribution to value creation. It has therefore been argued that the Court adopted a relatively narrow understanding of substance, centred mainly on the existence of assets and personnel, which may leave the test susceptible to circumvention. Given the conceptual similarities, these considerations are equally relevant for interpreting the substance carve-out under the categorical approach.[64]

Although the substance carve-out closely mirrors the substance test developed in *Cadbury Schweppes*, certain differences remain. In particular, while the Court considered it sufficient for the controlled entity to carry on genuine economic activity, the wording of the ATAD refers to “substantive” economic activity, which could suggest a stricter threshold. In addition, whereas the Court provided indicative criteria for assessing genuineness, such guidance is not explicitly included in Article 7(2)(a) ATAD. Despite these textual differences, the interpretation of the substance carve-out must remain aligned with EU primary law, meaning that no higher standard than that established by the CJEU should be applied.[65]

Recent scholarship supports this interpretation, arguing that the substance requirement under the ATAD must be aligned with the concept of genuine economic activity developed in

[61] *Case C-196/04 Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue* EU:C:2006:544.
[62] Marjaana Helminen, ‘Threshold for the ATAD CFC Provision Substance Carve-Out to Apply: Significant, Substantive, Genuine or Real Economic Activities?’ (2025) 65(7) *European Taxation,* 316.
[63] Opinion in Case C-196/04, *Cadbury Schweppes*, EU:C:2006:278, para.113–114.
[64] Stefanie Geringer, ‘Substance Carve-Out and Function-Risk Analysis in the ATAD’s CFC Rule as Two Sides of the Same Coin: Strengths and Limits of a Uniform Concept of Abuse’ (2023) 60(1) *Common Market Law Review*, 155.
[65] Stefanie Geringer, ‘Substance Carve-Out and Function-Risk Analysis in the ATAD’s CFC Rule as Two Sides of the Same Coin: Strengths and Limits of a Uniform Concept of Abuse’ (2023) 60(1) *Common Market Law Review*, 155–158.

EU case law. Accordingly, economic activity may be regarded as genuine even if it is limited in scale, provided that it reflects real functions, assets, and risks. This interpretation prevents an overly restrictive application of CFC rules that could infringe on fundamental freedoms. At the same time, the assessment of substance must be based on objective criteria, including the existence of premises, staff, and equipment, as well as the actual conduct of business activities. These elements serve as indicators of economic reality and ensure that the substance test is applied consistently and verifiably.[66] However, the practical application of this threshold remains complex. As demonstrated in empirical studies, multinational enterprises may structure their operations to meet formal substance requirements while continuing to shift profits to low-tax jurisdictions.[67] This suggests that the current threshold may not fully capture all forms of tax avoidance and raises questions about whether the existing framework strikes an appropriate balance among legal certainty, economic freedom, and effective taxation. Ultimately, the substance requirement is closely linked to the broader notion of economic reality developed in CJEU case law. The decisive question is not the scale of the activity performed by the foreign entity, but whether the arrangement reflects genuine economic activity capable of explaining the allocation of functions, assets and risks to that entity.

Against this background, recent developments at the international level signal a complementary evolution of the tax framework. In particular, the OECD/G20 Pillar Two initiative departs from a purely substance-based approach by introducing a global minimum tax designed to limit the benefits of profit shifting irrespective of the level of economic activity in a given jurisdiction. This shift suggests that, while the concept of substance remains fundamental, it may no longer be sufficient on its own to safeguard tax bases in an increasingly integrated global economy.[68] The following chapter therefore, examines the Pillar Two rules and their interaction with the existing substance-based framework.

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[66] Monique T Malan, 'The De Minimis Exclusions in the ATAD's CFC Rules: A Normative Analysis' (2024) 52(12) *Intertax*, 798–800.
[67] Emilia Gschossmann and Alina Pfrang, 'Multinationals' Location, Financial and Real Responses to the EU-wide Implementation of CFC Rules by the ATAD' (2024).
[68] OECD, *Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two)* (OECD 2021) https://www.oecd.org/content/dam/oecd/en/publications/reports/2021/12/tax-challenges-arising-from-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two_eed81a23/782bac33-en.pdf accessed 13 May 2026.

3. Pillar Two and CFC Rules: Navigating Substance, Coordination and EU Law Constraints

While the previous chapter examined the role of substance as a limiting principle within EU CFC regimes, Pillar Two introduces a fundamentally different approach based on minimum taxation rather than the identification of abusive arrangements. The OECD/G20 Inclusive Framework has reached a broad consensus that competition among jurisdictions to attract investment and business activity constitutes a fundamental driver of base erosion and profit shifting. In response to these concerns, the OECD/G20 has introduced the Global Anti-Base Erosion (GloBE) proposal, which seeks to establish a global minimum level of taxation for multinational enterprises, irrespective of where they are incorporated or operate. The objective is to address harmful tax competition at the international level while preserving the fiscal sovereignty of individual jurisdictions and maintaining the coherence of the international tax framework. The GloBE regime is structured around two complementary mechanisms.[69] First, the Income Inclusion Rule (IIR) enables the jurisdiction of the ultimate parent entity to impose a top-up tax where the income of foreign subsidiaries is taxed below the minimum effective tax rate. In this way, the IIR seeks to neutralise incentives for profit shifting by reallocating taxing rights to the parent jurisdiction. Second, the Undertaxed Profits Rule (UTPR) functions as a complementary backstop where the IIR is not applied. It allows jurisdictions to deny deductions or adjust taxable income in order to ensure that the minimum level of taxation is achieved, thereby safeguarding the overall effectiveness of the regime.[70] In addition, source jurisdictions may apply withholding taxes under subject-to-tax rules to certain payments, such as interest or royalties, where these are taxed at a low rate in the recipient jurisdiction.[71]

These mechanisms are codified in the OECD's Global Anti-Base Erosion Model Rules and have been incorporated into EU law through the Minimum Taxation Directive (EU) 2022/2523. Member States were required to transpose the Directive into their domestic legal systems by 31 December 2023, with the IIR generally applicable from 2024 and the UTPR from 2025. Notwithstanding the broad international consensus supporting Pillar Two, its compatibility with EU primary law remains subject to debate. In particular, concerns have been

[69] Pitambar Das and Amedeo Rizzo, 'The OECD Global Minimum Tax Proposal Under Pillar Two: Will It Achieve the Desired Policy Objective?' (2022) 76(1) *Bulletin for International Taxation,* 44–45.
[70] Konstantia-Angeliki Tampakoudi, 'Pillar Two and the Fundamental Freedoms: Evaluating Luxembourg's Corporate Tax Framework in Light of EU Law' (2025) *European Taxation,* 418.
[71] Pitambar Das and Amedeo Rizzo, 'The OECD Global Minimum Tax Proposal Under Pillar Two: Will It Achieve the Desired Policy Objective?' (2022) 76(1) *Bulletin for International Taxation*, 44–45.

raised as to whether the regime may interfere with the fundamental freedoms, notably the freedom of establishment and the free movement of capital, where its application affects cross-border structures or imposes disproportionate tax burdens within the internal market.[72]

3.1 Pillar Two vs CFC Rules: Functional Comparison

CFC rules and the Pillar Two global minimum tax pursue closely related policy objectives, yet they operate through fundamentally different legal and technical mechanisms. Both frameworks aim to counter base erosion and profit shifting by limiting the ability of multinational enterprises (MNEs) to allocate income to low-tax jurisdictions. However, while CFC regimes focus on the current taxation of foreign subsidiary income in the hands of resident shareholders, Pillar Two introduces a jurisdictional minimum taxation mechanism designed to ensure a globally consistent effective tax rate. The Pillar Two Model Rules are, in principle, designed as a largely self-contained framework that operates independently from the specific features of domestic tax systems. This structural autonomy contributes significantly to their complexity, as the rules cannot rely on national legal definitions, which vary considerably across jurisdictions, while at the same time aiming to ensure consistent outcomes on a global scale. Nevertheless, this independence is not absolute. In practice, the application of the Model Rules inevitably depends on elements derived from domestic law, including certain tax base calculations and legal relationships. Furthermore, in the absence of explicit interpretative provisions, undefined terms used within the Model Rules may be interpreted by reference to domestic law, which may give rise to inconsistencies. CFC rules traditionally operate by disregarding, to a certain extent, the separate legal personality of foreign subsidiaries, attributing their income to controlling shareholders irrespective of actual distribution. This mechanism is primarily anti-deferral and typically targets at passive or mobile income, although some jurisdictions extend it to broader categories of income. By contrast, Pillar Two does not attribute income to shareholders as such. Instead, it establishes a top-up tax system based on the effective tax rate (ETR) of each jurisdiction in which an MNE operates. Where income is taxed below the agreed minimum rate of 15%, the system imposes additional taxation, most notably through the Income Inclusion Rule (IIR), to bring the overall tax burden up to the minimum threshold. A further structural distinction lies in the level of analysis. CFC regimes

[72] Konstantia-Angeliki Tampakoudi, 'Pillar Two and the Fundamental Freedoms: Evaluating Luxembourg's Corporate Tax Framework in Light of EU Law' (2025) *European Taxation,* 418.

generally operate on an entity or transaction-based basis, depending on national design, whereas Pillar Two adopts a jurisdictional blending approach, aggregating income and taxes of all constituent entities within a jurisdiction before determining whether a top-up tax is required. Despite these differences, there is a notable functional overlap. Both regimes effectively target low-taxed foreign income and may apply concurrently to the same income streams. However, while CFC rules are primarily preventive (prophylactic), designed to discourage profit shifting, Pillar Two is corrective, ensuring that any residual low-taxed income is ultimately subject to a minimum level of taxation. Another important divergence concerns the tax base and allocation of taxing rights. Under CFC rules, taxation is imposed by the shareholder's residence state, typically accompanied by foreign tax credits to mitigate double taxation. In contrast, Pillar Two allocates taxing rights across jurisdictions through a coordinated system involving the ultimate parent entity and, where necessary, other jurisdictions applying backstop mechanisms. Overall, while both systems address similar risks, Pillar Two represents a shift from entity-based anti-abuse rules to a systemic minimum taxation framework, thereby complementing rather than replacing traditional CFC regimes.[73]

3.2 Interaction Between Pillar Two and CFC Regimes

The interaction between CFC rules and the Pillar Two Model Rules is both complex and structurally significant, as both regimes may apply simultaneously to the same income. Crucially, the Pillar Two framework does not displace domestic CFC rules, instead, it is designed to operate alongside them. A central feature of this interaction lies in the treatment of taxes imposed under CFC regimes within the Pillar Two system. Under the Model Rules, such taxes are not attributed to the jurisdiction of the parent company that levies them. Instead, they are generally reallocated to the jurisdiction in which the controlled foreign company is located, thereby increasing that jurisdiction's effective tax rate for purposes of the global minimum tax calculation. This mechanism ensures a closer alignment between the location of income generation and the allocation of taxes, preventing distortions that would otherwise arise if CFC taxes were treated solely as taxes of the parent jurisdiction. As a result, the application of CFC rules may directly influence whether additional top-up taxation is required under Pillar Two. However, the Model Rules introduce a limitation with respect to passive income, whereby only

[73] B J Arnold, 'An Investigation into the Interaction of CFC Rules and the OECD Pillar Two Global Minimum Tax' (2022) 76(6) *Bulletin for International Taxation*, 275–288.

a capped portion of CFC taxes attributable to such income can be allocated to the jurisdiction of the CFC. Any excess CFC tax remains in the parent jurisdiction, potentially leading to situations where the global effective tax rate exceeds the minimum threshold. From a systemic perspective, this interaction reflects a balancing exercise. On the one hand, allocating CFC taxes to the source jurisdiction supports the coherence of the Pillar Two framework. On the other hand, the limitations imposed, particularly for passive income, ensure that CFC regimes do not fully substitute for the global minimum tax, thereby preserving the integrity of Pillar Two as an autonomous mechanism.[74]

An additional layer of complexity arises from the broad definition of a "CFC tax regime" within the Model Rules. This definition is intentionally expansive and captures a wide variety of domestic regimes that impose current taxation on foreign income, irrespective of their formal designation. At the same time, it may give rise to interpretative uncertainties, particularly where domestic regimes deviate from traditional CFC structures. A key preliminary issue in analysing the interaction between CFC rules and the Pillar Two framework is whether a jurisdiction's domestic provisions fall within the scope of the Model Rules. The Pillar Two Model Rules define a controlled foreign company tax regime as: *"a set of rules (other than an IIR) under which a direct or indirect shareholder of a foreign entity (the controlled foreign company or CFC) is subject to current taxation on its share of part or all of the income earned by the CFC, irrespective of whether that income is distributed currently to the shareholder."*[75] Where domestic rules, regardless of their formal designation, meet this definition, they are subject to the specific provisions governing taxes arising under a CFC regime within the Pillar Two system. Conversely, where national rules fall outside this definition, such provisions do not apply. It should, however, be emphasised that satisfying this definition constitutes only a threshold requirement. The Model Rules impose additional conditions that must be fulfilled before the special treatment of CFC taxes becomes applicable, meaning that qualification as a CFC tax regime is necessary but not, in itself, sufficient.[76]

Although the definition of a CFC tax regime under the Pillar Two Model Rules broadly captures the essential features of CFC legislation, it raises a number of interpretative and practical concerns. First, its intentionally broad formulation seeks to accommodate the diversity of existing CFC regimes across jurisdictions, yet may still fail to cover certain domestic rules

[74] B J Arnold, 'An Investigation into the Interaction of CFC Rules and the OECD Pillar Two Global Minimum Tax' (2022) 76(6) *Bulletin for International Taxation*, 275–289.
[75] Art. 10.1.1. Model Rules.
[76] B J Arnold, 'An Investigation into the Interaction of CFC Rules and the OECD Pillar Two Global Minimum Tax' (2022) 76(6) *Bulletin for International Taxation*, 275–289.

with similar objectives, such as foreign investment fund regimes. These regimes, which often apply to minority shareholdings not covered by traditional CFC rules, may also give rise to current taxation of foreign income, creating uncertainty about whether taxes levied under such frameworks fall within the scope of the Model Rules. Secondly, the definition relies on concepts such as "foreign entity" and "shareholder", which may create ambiguity regarding non-corporate structures or entities without formal shareholders. Moreover, the absence of a clear definition of "control" suggests that the scope of the Model Rules is not limited to strictly controlled entities but may also extend to situations involving significant yet non-controlling interests, provided that the relevant entities are included in the consolidated financial statements of a multinational group. A further challenge concerns the interpretation of the Model Rules more generally, as they currently lack a dedicated dispute resolution mechanism, potentially leading to divergent applications across jurisdictions. Importantly, the Pillar Two framework does not replace domestic CFC regimes but operates alongside them. Both systems may therefore apply concurrently, despite differences in their underlying design. While the income inclusion rule (IIR) shares certain similarities with CFC rules, it is explicitly excluded from the definition of a CFC tax regime due to differences in structure and policy rationale. In particular, the Pillar Two minimum tax operates on a jurisdictional effective tax rate basis, whereas CFC rules typically focus on specific categories of income and anti-avoidance considerations. Finally, uncertainty also arises with regard to the treatment of permanent establishments. Although PEs are recognised within the Pillar Two framework, it remains unclear to what extent domestic rules targeting the low-taxed income of foreign PEs fall within the definition of a CFC tax regime. This may lead to inconsistencies, particularly where different domestic approaches achieve comparable outcomes but are treated differently under the Model Rules.[77]

Moreover, the interaction between the two systems raises important interpretative and coordination challenges. Divergences may occur where jurisdictions disagree on whether particular domestic rules fall within the scope of a CFC tax regime, or on the characterization of income as passive or non-passive. Notably, the Model Rules do not currently provide a comprehensive dispute resolution mechanism to address such conflicts, which may lead to inconsistencies in their application across jurisdictions. Finally, although CFC rules and Pillar Two share similar policy objectives, namely, the prevention of profit shifting and the taxation of low-taxed income, they differ significantly in their design, scope, and operational logic. While CFC regimes remain targeted anti-abuse instruments rooted in domestic tax policy, Pillar

[77] B J Arnold, 'An Investigation into the Interaction of CFC Rules and the OECD Pillar Two Global Minimum Tax' (2022) 76(6) *Bulletin for International Taxation*, 275–289.

Two introduces a coordinated, multilateral framework that operates at the level of the global tax system.[78]

Although Pillar Two is often described as targeting "excess profits" or economic rents, this characterisation is not entirely accurate. The design of the Substance-based income exclusion (SBIE) does not ensure full exemption of normal returns, a defining feature of a true rent-based tax system. Several structural limitations confirm this conclusion. First, the absence of a carry-forward mechanism for unused carve-out amounts means that normal returns may still be subject to top-up taxation in subsequent periods. Second, the use of standardised percentages fails to reflect sectoral and jurisdictional differences in expected returns. Third, the exclusion of intangible assets leads to the taxation of income derived from genuine innovation as if it were excess profit. Consequently, Pillar Two cannot be understood as a pure tax on economic rents, but rather as a pragmatic minimum tax mechanism, based on simplified proxies that only imperfectly distinguish between normal and excess returns. The SBIE may also produce unintended allocative effects by influencing real economic decision-making. Since the carve-out is directly linked to the presence of tangible assets and employees within a jurisdiction, multinational enterprises may have an incentive to adjust the geographical allocation of these factors in order to reduce their exposure to top-up taxation. This raises the possibility that investment decisions are driven not solely by pre-tax economic efficiency but also by the tax advantages associated with the SBIE. Although empirical evidence suggests that such behavioural responses may be moderate, existing studies indicate that multinational groups adjust both profit allocation and, to some extent, real economic activity in response to substance-based rules. Furthermore, the effects of the SBIE are not uniform across jurisdictions. Countries with more developed infrastructure and higher levels of capital investment are better positioned to benefit from the carve-out, as they can generate larger exclusions from the tax base. In contrast, less developed economies may derive limited benefit from the SBIE, thereby exacerbating existing disparities in their ability to attract investment.[79]

[78] B J Arnold, 'An Investigation into the Interaction of CFC Rules and the OECD Pillar Two Global Minimum Tax' (2022) 76(6) *Bulletin for International Taxation*, 275–289.
[79] Ramon Tomazela, 'Pillar Two and the Tax Policy Challenges of the Substance-Based Income Exclusion' (2026) 80(3) *Bulletin for International Taxation* 1–5.

3.3 The Role of Substance under the Pillar Two

Once a jurisdiction's rules qualify as a CFC tax regime under the Model Rules, the Pillar Two provisions operate largely autonomously in relation to such regimes. Consequently, the key issue is whether domestic CFC rules fall within the relevant definition. After this threshold is met, the Model Rules apply to CFC taxation independently of the domestic framework, although certain interactions and interpretative challenges between the two systems may still arise.[80] Within the architecture of Pillar Two, the concept of substance plays a central, albeit somewhat controversial, role. Unlike traditional anti-avoidance rules, which primarily focus on identifying artificial arrangements, the Pillar Two framework introduces a substance-based carve-out to exclude a portion of income linked to real economic activity from the scope of the global minimum tax. The rationale behind this carve-out is closely connected to the broader objective of aligning taxation with value creation, a principle that has become fundamental in post-BEPS international tax policy. Under the IIR, low-taxed income of foreign entities may be subject to a top-up tax at the level of the parent company. However, the substance-based carve-out limits this effect by excluding a "routine" return associated with tangible assets and payroll, thereby ensuring that not all income is automatically treated as low-taxed or artificially shifted. In operational terms, the carve-out adopts a formulaic approach, granting an exclusion based on a fixed percentage of payroll costs and the carrying value of tangible assets. This design reflects the assumption that such factors are less mobile and therefore less prone to tax-motivated relocation. As a result, Pillar Two primarily targets "excess profits," particularly those linked to intangible assets, which are considered more susceptible to base erosion and profit shifting. At the same time, this approach reveals a significant conceptual tension. While the carve-out ostensibly preserves taxation aligned with real economic activity, its limited scope may fail to fully capture the complexity of value creation. In particular, by focusing predominantly on tangible assets and payroll, the mechanism risks underrepresenting the contribution of highly skilled labour, innovation, and intellectual property. Consequently, even income derived from genuinely substantive and high-value activities may fall within the scope of the IIR and be subject to top-up taxation. This limitation has important implications. It suggests that the Pillar Two framework implicitly distinguishes between "routine" and "non-routine" returns, treating only the former as sufficiently linked to substance. However, such a

[80] B J Arnold, 'An Investigation into the Interaction of CFC Rules and the OECD Pillar Two Global Minimum Tax' (2022) 76(6) *Bulletin for International Taxation*, 275.

distinction does not necessarily reflect economic reality, especially in knowledge-based economies where value creation is increasingly driven by intangible assets and highly specialised functions. Furthermore, the narrow design of the substance-based carve-out raises concerns from the perspective of tax sovereignty and policy autonomy. By allowing other jurisdictions to impose a top-up tax where the effective tax rate falls below the minimum threshold, the IIR may effectively neutralise domestic tax incentives, even where these incentives are aimed at attracting genuine economic activity. In this sense, the carve-out can be seen not merely as a technical adjustment, but as a limitation on the extent to which jurisdictions can exercise their taxing rights in relation to substantive activities carried out within their territory. From a systemic perspective, the substance-based carve-out therefore performs a dual function. On the one hand, it acts as a safeguard ensuring that Pillar Two does not entirely disregard the principle of value creation. On the other hand, its restrictive design reveals a shift away from a purely substance-based allocation of taxing rights towards a more formula-driven, globally coordinated minimum-taxation system. In this context, the role of substance under Pillar Two differs fundamentally from its role in CFC regimes. While CFC rules, particularly within the EU, using substance as a threshold test to distinguish genuine from artificial arrangements, Pillar Two employs substance in a quantitative and limiting manner, determining only the portion of income that may escape minimum taxation. This distinction highlights a broader transformation in international tax law: substance is no longer solely a qualitative anti-abuse concept, but increasingly a mechanical parameter within global tax coordination rules. In this sense, Pillar Two represents a shift from a substance-based anti-abuse paradigm towards a tax-rate-based model of international tax coordination. Whereas substance under CFC regimes functions primarily as a legal safeguard against disproportionate taxation, under Pillar Two, it operates as a quantitative adjustment mechanism within the effective tax rate calculation.[81]

The SBIE under Pillar Two does not merely reflect a technical adjustment, but rather embodies a broader policy compromise between competing conceptions of international tax competition. On the one hand, traditional OECD thinking accepted tax competition as legitimate, provided it was linked to substantive economic activity. On the other hand, the post-BEPS framework increasingly seeks to constrain tax competition more broadly through the introduction of a global minimum tax. Within this context, the SBIE represents a middle ground. By excluding a fixed return associated with tangible assets and payroll, it preserves a limited space for tax competition related to real investment, while simultaneously allowing

[81] Luís Eduardo Schoueri, 'Some Considerations on the Limitation of Substance-Based Carve-Out in the Income Inclusion Rule of Pillar Two' (2021) 75(11/12) *Bulletin for International Taxation*, 545–548.

Pillar Two to target residual or "excess" profits. However, this design does not reflect a fully coherent policy position; rather, it reveals an unresolved tension between preserving tax sovereignty and restricting tax competition globally.[82]

3.4 Pillar Two in Light of EU Law Principles

The implementation of Pillar Two within EU Member States raises important questions regarding its compatibility with the EU legal framework, in particular the fundamental freedoms enshrined in the TFEU, notably the freedom of establishment and the free movement of capital. These freedoms limit national tax measures that adversely affect cross-border economic activity unless such measures are justified by overriding reasons in the public interest and comply with the principle of proportionality. In this context, the application of top-up taxation may produce restrictive effects, particularly where it neutralises domestic tax advantages, such as participation exemptions, or leads to the re-taxation of income already taxed abroad, thereby potentially discouraging cross-border investment. A central point of tension arises from the methodological divergence between ATAD-based CFC rules and the Pillar Two framework. While CFC regimes are grounded in a targeted anti-abuse rationale and incorporate substance-based safeguards that allow taxpayers to demonstrate the existence of genuine economic activity, Pillar Two operates primarily through a mechanical effective tax rate calculation. This approach does not provide for a comparable qualitative assessment of economic substance, beyond limited formula-based carve-outs. As a result, taxation under Pillar Two may extend to situations involving genuine economic activity, thereby giving rise to potentially disproportionate outcomes.[83] This conceptual shift becomes particularly evident in the operation of the IIR, which constitutes the core mechanism of the GloBE framework. The IIR attributes the low-taxed income of foreign subsidiaries to the parent entity and imposes a top-up tax to ensure a minimum level of taxation. Although functionally comparable to CFC rules, the IIR differs fundamentally in that it applies automatically whenever the effective tax rate falls below the agreed threshold, irrespective of whether the underlying arrangements are artificial or reflect genuine commercial activity. From an EU law perspective, such a mechanism is liable to constitute a restriction on the freedom of establishment, as it results in

[82] Ramon Tomazela, 'Pillar Two and the Tax Policy Challenges of the Substance-Based Income Exclusion' (2026) 80(3) *Bulletin for International Taxation* 1–5.
[83] Konstantia-Angeliki Tampakoudi, 'Pillar Two and the Fundamental Freedoms: Evaluating Luxembourg's Corporate Tax Framework in Light of EU Law' (2025) *European Taxation,* 420–422.

less favourable treatment of parent companies with subsidiaries in low-tax jurisdictions compared to purely domestic group structures. According to the settled case law of the CJEU, differences in taxation between Member States, including the availability of more favourable regimes, are an inherent feature of the internal market and cannot, in themselves, justify restrictive measures. In particular, the Court has emphasised in cases such as *Cadbury Schweppes* and *Marks & Spencer* that anti-avoidance measures must be specifically targeted at wholly artificial arrangements and must allow taxpayers to demonstrate legitimate commercial justification. More recently, the Court confirmed in *Lexel AB*[84] that anti-avoidance measures cannot rely on broad presumptions of tax avoidance and must remain proportionate where transactions are carried out under market conditions and reflect genuine commercial activity.

Against this background, the broad and automatic application of the IIR raises significant concerns under the principle of proportionality. Unlike traditional CFC rules, which limit their scope to non-genuine arrangements, the IIR applies to all low-taxed income without distinguishing between artificial structures and substantive business operations. Although the GloBE framework introduces a formulaic substance-based carve-out, its quantitative and standardised nature does not fully align with the qualitative substance assessment required under EU law. Consequently, even income derived from genuine economic activities, such as research and development or the exploitation of intangibles supported by real economic functions, may remain subject to top-up taxation. This results in a structural presumption that low-taxed income is indicative of base erosion, which departs from the EU law concept of abuse, which is based on an individualised assessment of economic reality. The absence of a meaningful rebuttal mechanism allowing taxpayers to demonstrate the genuine nature of their activities further reinforces this concern.[85] In this respect, the Pillar Two framework represents a significant departure from the substance-based anti-abuse paradigm reflected in ATAD-compliant CFC regimes and CJEU case law, towards a uniform and rate-based system of taxation. Overall, while Pillar Two and CFC rules pursue a common objective of addressing base erosion and profit shifting, their underlying logic differs fundamentally. CFC rules operate as targeted anti-abuse instruments constrained by proportionality and substance requirements, whereas Pillar Two introduces a broader and more rigid framework based on minimum taxation. This shift from a conduct-based to a rate-based approach gives rise to structural

[84] *Case C-484/19 Lexel AB v Skatteverket EU:C:2021:34*.
[85] Luc De Broe and Mélanie Massant, 'Are the OECD/G20 Pillar Two GloBE-Rules Compliant with the Fundamental Freedoms?' (2021) 30(3) *EC Tax Review,* 86.

tensions with the principles governing the EU internal market and raises legitimate questions as to the compatibility of the GloBE framework with EU constitutional standards.[86]

These issues become particularly relevant when examining the operation of national CFC regimes, as the interaction between ATAD-based substance requirements and the Pillar Two framework may produce different outcomes depending on domestic implementation choices. The following chapter therefore, analyses these questions in the context of Austria, Slovakia, Cyprus and Luxembourg.

4. Comparative Analysis: Austria, Slovakia, Cyprus and Luxembourg

Building on the preceding analysis of the design and function of CFC rules within the EU framework, as well as their evolving interaction with the Pillar Two, this chapter undertakes a comparative assessment of selected national regimes. The focus is on Austria, Slovakia, Cyprus and Luxembourg, which represent jurisdictions with differing tax policy approaches, economic structures, and implementation strategies within the EU legal framework.

The objective of this chapter is to examine how these jurisdictions have transposed the ATAD CFC rules into their domestic legal systems and how they interpret and apply key concepts, in particular the substance requirement. Special attention is given to the extent to which national regimes reflect the constraints imposed by EU primary law, notably the fundamental freedoms and the prohibition of abuse, and how they adapt to the emerging architecture of Pillar Two.

For each jurisdiction, the analysis will focus on several core aspects. First, it will assess the structural design of the domestic CFC regime, including whether it follows a categorical or transactional approach. Second, it will examine the interpretation and practical application of the substance carve-out, with a view to identifying differences in the required threshold of economic activity. Third, the interaction between domestic rules and EU primary law will be analysed, particularly in light of the jurisprudence of the CJEU. Fourth, the chapter will explore how domestic CFC regimes interact with the Pillar Two framework, including the extent to which they retain practical relevance in a minimum tax environment.

The comparative analysis aims to identify and evaluate key divergences across jurisdictions, including variations in substance thresholds, differences in the intensity and scope

[86] Konstantia-Angeliki Tampakoudi, 'Pillar Two and the Fundamental Freedoms: Evaluating Luxembourg's Corporate Tax Framework in Light of EU Law' (2025) *European Taxation*, 420–422.

of anti-avoidance measures, and the extent to which CFC rules continue to play a meaningful role alongside the global minimum tax. In doing so, the chapter seeks to assess whether the interaction between CFC regimes and Pillar Two results in a coherent and effective framework or whether it gives rise to fragmentation and legal uncertainty within the EU.

4.1 Austria: CFC Taxation Based on Functions and Risks

The implementation of the ATAD in Austria was carried out through the Annual Tax Act 2018 (Jahressteuergesetz 2018), published in the Austrian Federal Law Gazette on 14 August 2018. This new legislation introduced a CFC regime as an initial measure to implement Articles 7 and 8 of the EU Anti-Tax Avoidance Directive 2016/1164, with the aim of complying with the transposition deadline of 1 January 2019 set by the Directive. In implementing the ATAD, Austria opted for the categorical – entity-based approach under Article 7 (2)(a), thereby focusing on the inclusion of low-taxed passive income rather than targeting exclusively non-genuine arrangements as envisaged under the alternative transactional approach. Consequently, the Austrian CFC regime operates by attributing certain categories of income earned by a foreign-controlled entity to the Austrian corporate shareholder, provided that the relevant conditions are met.[87]

The regime, codified in § 10a of the Austrian Corporate Income Tax Act (ACITA)[88], applies where a domestic corporation, an Austrian taxpayer, directly or indirectly controls a foreign entity that generates low-taxed passive income. The rules also extend to foreign permanent establishments whose income would otherwise be exempt in Austria. The scope of passive income is defined broadly and closely follows the ATAD. It includes, inter alia, interest or income from financial assets, intellectual property, including royalties and related gains, dividends and capital gains from the disposal of shares, financial leasing income, as well as income from insurance, banking, and similar financial activities. In addition, income derived from intra-group transactions involving entities, from clearing houses that generate income from the sale of goods and the provision of services acquired from and sold to affiliated companies, that add little or no economic value is also covered.[89] A central prerequisite for the application of the regime is the existence of low taxation, assessed by reference to the effective

[87] Binder Grösswang, 'Substantial Changes to Austria's International Tax Law Rules' (2018) https://www.bindergroesswang.at/insights/law-blog/newsletter/2018/substantial-changes-to-austrias-international-tax-law-rules accessed 28 April 2026.
[88] Körperschaftsteuergesetz 1988, BGBl No 401/1988, as amended.
[89] § 10a (1), (2) KStG.

foreign tax burden compared to the Austrian standard. While this threshold was originally set at no more than 12.5%, it has subsequently been increased to a uniform level of less than 15%, as further elaborated below.[90]

Furthermore, a de minimis threshold applies, whereby CFC rules are triggered only if passive income exceeds one-third of the total income of the foreign entity.[91] The requirement of control is satisfied where the Austrian taxpayer, either individually or together with associated enterprises, holds more than 50% of the voting rights, capital, or profit entitlement in the foreign entity – "controlled corporation".[92] The concept of an affiliated company is defined broadly, including both corporate and individual shareholders exceeding a 25% participation threshold.[93] Importantly, the inclusion of passive income is subject to a cumulative test, requiring (i) low taxation, (ii) control, and (iii) the absence of sufficient economic substance. In line with EU law, no inclusion arises where the controlled foreign entity carries on significant economic activity supported by personnel, equipment, assets, and premises.[94] The burden of proof in this regard lies with the taxpayer, making the substance test a central element of the Austrian CFC regime. This reflects the approach developed by the CJEU in *Cadbury Schweppes*, according to which taxpayers must be afforded an opportunity to demonstrate the existence of genuine economic activity. If the criteria are met, the passive income is attributed to the Austrian parent company and taxed at the Austrian corporate income tax rate, currently set at 23%, with a credit for foreign taxes paid. [95]

Regarding the Interaction with Pillar II, Austria implemented this framework in December 2023, building on its already established and comprehensive CFC regime introduced in 2018. While the initial EU legislative approach did not identify any fundamental conflict between CFC rules and the Pillar Two system, subsequent developments at the OECD level highlighted potential tensions. In particular, the OECD's Administrative Guidance[96] recognised that the concurrent application of Qualified Domestic Minimum Top-up Tax (QDMTTs) and CFC regimes may give rise to circular effects and, in certain cases, economic double taxation. This risk arises where a foreign subsidiary is subject to a QDMTT that increases its effective tax rate to the minimum level of 15%, yet the same income remains subject to inclusion and

[90] §10a (3) KStG.
[91] § 10a (4) 1. KStG.
[92] § 10a (4) 2. KStG.
[93] § 10a (4) 2. a), b) KStG.
[94] § 10a (4) 3. KStG.
[95] Binder Grösswang, 'Substantial Changes to Austria's International Tax Law Rules' (2018) https://www.bindergroesswang.at/insights/law-blog/newsletter/2018/substantial-changes-to-austrias-international-tax-law-rules accessed 28 April 2026.
[96] Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two) February 2023.

taxation under domestic CFC rules at parent company level. In response to these concerns, Austria amended its CFC provisions in § 10a of the CITA to better align with the Pillar Two framework and to mitigate the risk of double taxation. Under the revised approach, any QDMTT levied in the jurisdiction of the controlled foreign entity is taken into account when calculating the effective tax rate for CFC purposes. As a result, the Austrian CFC regime will generally not apply where the foreign entity is already subject to a QDMTT that ensures a minimum effective tax rate of 15%. This approach not only prevents potential economic double taxation but may also lead to a more favourable outcome for taxpayers. Unlike a system based solely on foreign tax credits, which could result in taxation up to the higher domestic rate, the Austrian model effectively neutralises the application of CFC rules where the minimum taxation requirement is already satisfied abroad. Nevertheless, in situations where the Austrian CFC regime is still triggered despite the existence of a QDMTT, for instance, where the application of the SBIE reduces the effective tax rate below the relevant threshold, any foreign QDMTT paid may be credited against the Austrian corporate income tax arising from the CFC inclusion. This ensures a degree of coordination between the two regimes, while also illustrating the continued complexity of their interaction in practice.[97]

More recently, an amendment to the Austrian Corporate Income Tax Act, adopted on 29 December 2025, further aligned and tightened the concept of low taxation by introducing a uniform effective tax rate threshold of 15%. This reform replaced the previously fragmented thresholds, which had varied across provisions, including those governing CFC rules, switch-over clauses, and the non-deductibility of certain payments.[98] The latest amendment harmonised these thresholds, particularly in relation to § 10a(3) ACITA, concerning passive income under the CFC regime, and § 12(1)(10) ACITA, relating to the non-deductibility of interest and royalty payments, thereby establishing a uniform benchmark. Under the revised framework, a foreign entity is regarded as low taxed where its effective tax rate falls below 15%. This represents a notable tightening compared to the previous thresholds, which were set at 12.5% for CFC purposes and at 10% for certain deductible payments. While the amendment primarily affects the applicable threshold, the substantive structure of the provisions remains unchanged. As a result, passive income earned by a foreign-controlled entity and subject to an effective tax rate below 15% must be included in the Austrian tax base of the controlling

[97] WTS Global, 'Austria Amends CFC Rules to Avoid Double Taxation Due to Pillar Two' (8 August 2024) https://wts.com/global/publishing-article/20240808-austria-amends-cfc-rules-to-avoid-double-taxation-due-to-pillar-II~publishing-article accessed 28 April 2026.
[98] PwC, 'Austria: Corporate – Other Taxes' *Worldwide Tax Summaries* (11 March 2026) https://taxsummaries.pwc.com/austria/corporate/other-taxes accessed 28 April 2026.

company under the CFC rules. The revised threshold applies to financial years beginning after 31 December 2025. The reform also affects related anti-avoidance measures, notably by restricting the deductibility of intra-group interest and royalty payments where the recipient is subject to low taxation below 15%. This development reflects a broader policy shift towards ensuring a minimum level of taxation, consistent with the objectives underlying the Pillar Two framework.[99]

To conclude, in substantive terms, the Austrian CFC regime largely mirrors the structure and wording of the ATAD. It applies to foreign entities directly or indirectly controlled by an Austrian corporate taxpayer and follows the categorical approach. Accordingly, it targets a broad range of passive income categories, including interest, royalties, dividends, and income from financial leasing. The regime is triggered where such income is subject to an effective tax rate below 15%, thereby capturing not only entities in traditional low-tax jurisdictions but also subsidiaries located within certain EU Member States. Once the conditions are met, the low-taxed passive income of the controlled entity is attributed to the Austrian shareholder and taxed at the domestic level, with relief provided through a credit for foreign taxes paid by the CFC. Austria has used the flexibility provided under the ATAD by extending the substance-based exemption (bona fide clause) to entities in third countries. In addition, a de minimis rule applies where passive income does not exceed 1/3 of the entity's total income, in which case the CFC rules are not triggered.[100]

The Austrian approach demonstrates a more developed and systematic implementation of the ATAD, relying on predefined income categories and a formalised substance carve-out, which ensures greater predictability but may also broaden the scope of application beyond purely artificial arrangements. It also represents the jurisdiction that has gone furthest in coordinating domestic CFC rules with the Pillar Two framework, thereby reducing the potential for overlapping taxation.

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[99] PwC, 'Amendments to Austrian Corporate Income Tax Act 1988' (20 January 2026) https://www.pwc.at/de/insights/austrian-tax-news/amendments-to-the-austrian-corporate-income-tax-act-1988-austrian-tax-amendment-act-2025-as-well-as-austrian-anti-fraud-act-2025-passed.html accessed 29 April 2026.

[100] PwC, 'Austria: Corporate – Other Taxes' *Worldwide Tax Summaries* (11 March 2026) https://taxsummaries.pwc.com/austria/corporate/other-taxes accessed 28 April 2026.

4.2 Slovakia: Broad CFC Taxation and Legislative Development

The Slovak CFC regime was introduced in line with the requirements of the ATAD and has been applied since 1 January 2019. The amendment to the Slovak Income Tax Act No. 595/2003 Coll., as amended (SITA), has sparked controversy regarding the implementation of this concept. The Slovak CFC regime is based on a look-through mechanism, under which the legal and tax separateness of the controlled foreign entity is effectively set aside. Consequently, income that has been shifted from the Slovak parent is attributed back to the controlling company and taxed at the domestic level. In conceptual terms, the Slovak implementation largely mirrors the structure and policy objectives of the ATAD framework[101]and are therefore expected to comply with EU primary law, in particular the fundamental freedoms.

According to Section 17h(4) of the SITA, *"the tax base of a taxpayer under Section 2(d) d), second point, the income of a controlled foreign company arising from a measure or several measures which are not genuine and which were carried out for the purpose of obtaining a tax advantage to the extent that no adjustment of the tax base was made in respect of them pursuant to Section 17(5)(a)"*. It follows that the Slovak Republic has decided to implement CFC rules in the form of the aforementioned Article 7(2)(b) of the ATAD Directive.[102] Consequently, in structural terms, the Slovak regime reflects elements of the transactional approach, as it focuses on the attribution of income that lacks sufficient economic justification or is primarily intended to obtain a tax advantage. The regime applies where a Slovak taxpayer directly or indirectly controls a foreign entity and where that entity is subject to low taxation. A foreign entity is considered a CFC where two cumulative conditions are met. First, the entity must be directly or indirectly controlled by a Slovak taxpayer through voting rights, capital participation or entitlement to profits of more than 50%.[103] Second, the effective corporate income tax paid by the foreign entity must be lower than half of the tax that would have been payable under the applicable corporate tax system in the Slovak Republic. [104] In the case of PEs, only the condition relating to low taxation is required to apply the CFC regime.[105] Where these conditions are satisfied, the CFC's income is attributed to the Slovak parent company and included in its tax

[101] Matej Kačaljak and Andrea Koroncziová, 'Controlled Foreign Company Legislation in the Slovak Republic' in Georg Kofler and others (eds), *Controlled Foreign Company Legislation* (IBFD 2020), 645.
[102] M Kačaljak, 'Vybrané súvislosti transpozície smernice ATAD do slovenského právneho poriadku' in *I. slovensko-české dni daňového práva (Daňové úniky a vyhýbanie sa daňovým povinnostiam): Recenzovaný zborník vedeckých prác* (Univerzita Pavla Jozefa Šafárika v Košiciach 2017), 202.
[103] § 17h (1) a) ITA.
[104] § 17h (1) b) ITA.
[105] § 17h (3) ITA.

base. The substance assessment is embedded in a function-risk analysis, whereby income is attributed to the Slovak parent only to the extent it relates to assets and risks associated with significant functions performed by that parent.[106] In this respect, the Slovak approach reflects principles derived from the arm's length standard and transfer pricing, particularly in relation to the allocation of income based on value-creating activities. To prevent double taxation, the Slovak parent company is entitled to take into account taxes already paid by the CFC abroad and may be credited against the taxpayer's final tax liability.[107] Moreover, where adjustments based on transfer pricing rules are applicable, these take precedence over the application of the CFC rules. The attributed income is generally taxed at progressive rates, currently set at 25 % or 35 %, and taxation arises at the moment the taxpayer acquires the right to the income, irrespective of its actual distribution. Certain exceptions apply, limiting the scope of this mechanism in specific circumstances. [108] Notably, the regime does not provide for a formal substance carve-out; instead, substance is assessed indirectly through the functional allocation of profits.[109]

In addition to corporate taxpayers, Slovak tax law extended the scope of CFC rules to natural persons with effect from 1 January 2022. While pursuing the legitimate objective of preventing profit shifting to low-tax jurisdictions, the design of these rules raised several concerns. A key issue lies in the low control threshold of 10%, which significantly departs from international standards and may result in the application of CFC rules even in the absence of genuine control. Furthermore, the broad definition of a CFC, potentially encompassing various types of entities, contributes to legal uncertainty. Additional shortcomings relate to the lack of clarity in legislative drafting and the risk of economic double taxation, particularly due to the absence of mechanisms for loss relief and the potential for multiple taxation within corporate structures. Taken together, these features raised concerns regarding proportionality and compatibility with EU law, especially in light of the fundamental freedoms.[110] Ultimately, the CFC rules applicable to individuals were abolished with effect from 1 August 2023. According to the explanatory memorandum to the amendment, the primary reason for their repeal was the

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[106] Matej Kačaljak and Andrea Koroncziová, 'Controlled Foreign Company Legislation in the Slovak Republic' in Georg Kofler and others (eds), *Controlled Foreign Company Legislation* (IBFD 2020), 645–647.
[107] KPMG, *Tax Card 2020 (Slovakia)* (2020) https://assets.kpmg.com/content/dam/kpmg/sk/pdf/2020/tax-card_2020.pdf accessed 1 May 2026.
[108] PwC, 'Slovak Republic: Corporate – Group Taxation' *Worldwide Tax Summaries* (20 January 2026) https://taxsummaries.pwc.com/slovak-republic/corporate/group-taxation accessed 29 April 2026.
[109] Matej Kačaljak and Andrea Koroncziová, 'Controlled Foreign Company Legislation in the Slovak Republic' in Georg Kofler and others (eds), *Controlled Foreign Company Legislation* (IBFD 2020), 650.
[110] Miriam Galandová, 'Nové CFC pravidlá pre fyzické osoby' (2021) *Bulletin Slovenskej komory daňových poradcov*, 6–12.

emergence of significant concerns in practice regarding their proportionality and overall effectiveness.[111]

Regarding the Interaction with Pillar II, Slovakia introduced this framework through domestic top-up tax legislation applicable from 2024, implementing the requirements of the Council Directive EU 2022/2523. The Slovak approach is characterised by the introduction of a QDMTT, while deferring the application of the IIR and UPR under Art. 50 of the Directive.[112] This framework operates alongside the existing Slovak CFC regime but is conceptually distinct. While CFC rules target non-genuine arrangements and rely on a function–risk analysis to attribute income to the Slovak controlling entity, Pillar Two applies a jurisdictional effective tax rate test, without requiring any assessment of artificiality or economic substance. As a result, income that falls outside the scope of Slovak CFC rules due to the presence of genuine economic activity may nevertheless be subject to a top-up tax under Pillar Two where the effective tax rate in the relevant jurisdiction does not reach the 15% threshold.[113] Conversely, where CFC inclusion applies, the resulting increase in the tax burden at the level of the Slovak parent entity may raise the effective tax rate, thereby reducing or eliminating any Pillar Two top-up tax liability.[114] This interaction demonstrates a partial functional overlap between the two regimes, as both seek to address base erosion and profit shifting, albeit through different conceptual frameworks.[115] At the same time, the coexistence of these mechanisms may create risks of cumulative taxation and increased compliance complexity, particularly in situations involving transfer pricing adjustments, CFC income inclusion, and GloBE calculations.[116] Despite these differences, both regimes pursue a similar policy objective, namely the reduction of profit shifting to low-tax jurisdictions. In practice, the introduction of Pillar Two may reduce incentives for such arrangements and thereby limit the relevance of CFC rules in certain cases. However, the Slovak CFC regime retains its importance as a targeted anti-abuse instrument,

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[111] Štěpán Štarha and Kristína Očenášová, 'Zrušenie (CFC) pravidiel týkajúcich sa kontrolovaných zahraničných spoločností pre fyzické osoby od 1. augusta 2023' https://www.havelpartners.sk/zrusenie-cfc-pravidiel-tykajucich-sa-kontrolovanych-zahranicnych-spolocnosti-pre-fyzicke-osoby-od-1-augusta-2023/ accessed 1 May 2026.

[112] KPMG, *EU Direct Tax Initiatives: 2025 Year-End State of Play (ETF 572)* (18 December 2025) https://assets.kpmg.com/content/dam/kpmgsites/xx/pdf/2025/12/etf-572-2025-year-end-state-of-play.pdf accessed 2 May 2026.

[113] 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 L 328/1.

[114] OECD, *Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two)* (February 2023).

[115] Council Directive (EU) 2016/1164 (n 2).

[116] B J Arnold, 'An Investigation into the Interaction of CFC Rules and the OECD Pillar Two Global Minimum Tax' (2022) 76(6) *Bulletin for International Taxation*, 275.

particularly where income is artificially allocated through structures that do not reflect economic reality.[117]

In conclusion, the Slovak CFC regime illustrates a minimalist implementation of the ATAD, combining a transaction-based anti-abuse approach with transfer pricing logic, but at the cost of increased complexity and limited practical effectiveness. The Slovak CFC rules are closely aligned with the ATAD and are therefore expected to comply with EU primary law, in particular the fundamental freedoms. The choice of the transactional approach appears particularly relevant in this context, as it allows the Slovak regime to operate within the limits imposed by EU law by targeting only non-genuine arrangements rather than applying a broad anti-deferral mechanism. However, this design also increases the importance of transfer-pricing assessments and may reduce legal certainty compared to more rule-based CFC models.[118]

4.3 Cyprus: Economic Substance within a Low-Tax Environment

The Law 63(l)/2019, enacted on April 25 2019. implemented the ATAD into the Cyprus tax law. Cyprian CFC rules were introduced as an amendment to the Income Tax Law (Law 118 (l)/2002 (CITL)), with effect from 1 January 2019, to subject the undistributed income of foreign subsidiaries located in low-tax jurisdictions to taxation.[119] Cyprus implemented the ATAD CFC provisions in a manner that largely adheres to the minimum harmonisation standard, without extending its scope beyond what is required under EU law. The regime is based on a “piercing-the-veil” approach, whereby the separate legal personality of the controlled foreign company is disregarded for tax purposes and the relevant income is attributed to the Cyprus-resident shareholder.[120]

In accordance with Article 36A, the classification of a foreign entity as a Controlled Foreign Company depends on the fulfilment of specific statutory criteria. First, the control threshold must be met, whereas a controlled foreign company is defined as a non-resident entity in which a Cyprus corporate taxpayer, either alone or together with associated enterprises, holds

[117] PwC, ‘Slovak Republic: Corporate – Group Taxation’ *Worldwide Tax Summaries* (20 January 2026) https://taxsummaries.pwc.com/slovak-republic/corporate/group-taxation accessed 29 April 2026
[118] Matej Kačaljak and Andrea Koroncziová, ‘Controlled Foreign Company Legislation in the Slovak Republic’ in Georg Kofler and others (eds), *Controlled Foreign Company Legislation* (IBFD 2020), 645–650.
[119] KPMG, *Cyprus Implementation of the Anti-Tax Avoidance Directive* (2020) https://assets.kpmg.com/content/dam/kpmg/cy/pdf/2020/07/Anti-Tax-avoidance-directive-july-2020.pdf accessed 1 May 2026.
[120] Eleni Apostolidou, ‘Controlled Foreign Company Legislation in Cyprus’ in Georg Kofler and others (eds), *Controlled Foreign Company Legislation* (IBFD 2020), 202.

a direct or indirect participation exceeding 50%.[121] The scope of the regime also extends to foreign permanent establishments of Cypriot taxpayers that are exempt from taxation in Cyprus.[122] The second condition requires low taxation, in which a foreign entity or permanent establishment is regarded as low-taxed if the effective corporate income tax paid abroad is lower than 50% of the tax that would have been payable under Cypriot tax rules had the entity been resident in Cyprus. Given that the corporate income tax rate in Cyprus is 15%, this implies that the foreign effective tax rate must fall below 7.5% for the low-tax condition to be satisfied.[123] This comparative approach aligns the assessment of low taxation with a hypothetical domestic tax benchmark. The application of the rules is deliberately limited. Only undistributed income is subject to inclusion, and this income is calculated on the basis of accounting profits adjusted in accordance with domestic tax rules. Furthermore, the regime includes safe harbour provisions excluding entities with low profits or low profit margins, thereby restricting the application of the rules to cases involving meaningful risks of tax avoidance.[124] Therefore, certain exceptions apply, excluding entities from the scope of the CFC regime where they meet specific de minimis thresholds. In particular, the rules do not apply where the entity's accounting profits do not exceed EUR 750,000 and its non-trading income remains below EUR 75,000. Alternatively, an exemption is available where the accounting profits do not exceed 10% of the entity's operating costs for the relevant tax period, subject to certain adjustments.[125] Cyprus has opted for the transactional approach (Model B) as set out in the ATAD framework. Accordingly, where a foreign entity qualifies as a CFC, the Cypriot taxpayer is required to include in its taxable base the non-distributed income of the CFC, but only to the extent that such income arises from non-genuine arrangements established for the essential purpose of obtaining a tax advantage.[126] Non-distributed income is defined as the after-tax accounting profit of the CFC that has not been distributed to the Cypriot shareholder within the relevant tax year or within a specified subsequent period. The inclusion mechanism is therefore limited to retained earnings rather than distributed profits.[127] The assessment of whether an arrangement is non-genuine is based on a function–risk analysis, in line with ATAD

[121] Art. 36A. (1) CITA.
[122] Art. 36A. (11) CITA.
[123] Christos Philippou, 'Understanding the Rules on Controlled Foreign Companies (CFCs) Under Cyprus Tax Law' (28 March 2025) https://philippoulaw.com/articles/understanding-the-rules-on-controlled-foreign-companies-cfcs-under-cyprus-tax-law accessed 12 May 2026.
[124] Eleni Apostolidou, 'Controlled Foreign Company Legislation in Cyprus' in Georg Kofler and others (eds), *Controlled Foreign Company Legislation* (IBFD 2020), 202.
[125] Art. 36A. (6) (a) (b) CITA.
[126] Art. 36A. (2) CITA.
[127] Art. 36A. (9) CITA.

requirements.[128] The Cypriot CFC regime integrates a substance-based assessment closely aligned with transfer pricing principles and focuses on the allocation of value-creating activities. An arrangement is considered non-genuine where the CFC would not own the relevant assets or assume the associated risks in the absence of control by the Cypriot taxpayer, particularly where the significant people functions relevant to those assets and risks are carried out by the taxpayer. The analysis focuses on whether the assets and risks generating the income are effectively managed by personnel located in Cyprus. Where income is linked to genuine economic activity, it falls outside the scope of the CFC rules. This approach enhances predictability and reduces administrative complexity, as the assessment is anchored in observable factors such as functions, assets and risks.[129] The amount of income to be included in the tax base is limited to that attributable to the assets and risks linked to the significant functions performed by the Cypriot taxpayer and is determined in accordance with the arm's-length principle. The inclusion is further restricted to the proportion corresponding to the taxpayer's participation in the CFC and is recognised in the tax period in which the CFC's financial year ends. To prevent double taxation, Cyprus grants a credit for foreign taxes paid on the CFC's income. Additional safeguards ensure that income previously taxed under the CFC regime is not taxed again upon subsequent distribution or disposal of the underlying investment.[130]

Notwithstanding its targeted design, the Cypriot CFC regime raises a number of concerns regarding EU law. In particular, it has been argued that the rules may go beyond the standard established by the Court of Justice in *Cadbury Schweppes*, as they potentially apply to arrangements that are not wholly artificial. Furthermore, the absence of comprehensive mechanisms to eliminate double taxation and the possibility of overlapping application with other jurisdictions' CFC rules may lead to excessive tax burdens. More broadly, the introduction of CFC rules in Cyprus has been questioned from a policy perspective. Given the relatively limited exposure of the Cypriot tax base to base erosion and profit shifting risks, it has been suggested that the practical impact of these rules may be modest. This distinguishes Cyprus from jurisdictions such as Austria, where CFC rules perform a more central anti-avoidance function within the overall corporate tax framework. In this context, CFC legislation is not necessarily perceived as a key instrument for revenue generation, but rather as part of a

[128] Art. 33A. CITA.
[129] Eleni Apostolidou, 'Controlled Foreign Company Legislation in Cyprus' in Georg Kofler and others (eds), *Controlled Foreign Company Legislation* (IBFD 2020), 203.
[130] PwC, 'Cyprus: Corporate – Group Taxation' *Worldwide Tax Summaries* (1 July 2025) https://taxsummaries.pwc.com/cyprus/corporate/group-taxation accessed 30 April 2026.

broader effort to align with international and EU standards and to maintain credibility within the global tax framework.[131]

The interaction between the Cypriot CFC regime and the Pillar Two framework reveals both complementarities and potential tensions. While Cyprus applies the transactional approach under ATAD, targeting only income derived from non-genuine arrangements based on a function–risk analysis, the Pillar Two GloBE Rules operate on a fundamentally different basis by relying on a jurisdictional effective tax rate test without regard to economic substance. As a result, income that is excluded from the scope of Cyprus CFC rules due to the presence of genuine economic activity may nevertheless fall within the ambit of a Pillar Two top-up tax if the relevant jurisdictional effective tax rate falls below the 15% minimum threshold. Conversely, where CFC rules are triggered, the inclusion of low-taxed income at the level of the Cyprus parent may increase the effective tax rate and thereby reduce or eliminate any Pillar Two top-up tax liability. This interaction highlights a partial functional overlap between the two regimes, as both aim to counter base erosion and profit shifting, albeit through different conceptual mechanisms. At the same time, the coexistence of both systems may give rise to risks of economic double taxation or increased compliance complexity, particularly in cases where adjustments under transfer pricing, CFC inclusion, and GloBE calculations are applied cumulatively. The Cypriot approach, which closely aligns CFC rules with transfer pricing principles, further suggests that the role of traditional CFC regimes may increasingly converge with broader international tax standards, raising questions as to their continued independent relevance in a post-Pillar Two environment.[132] The Cypriot model, therefore, illustrates how a jurisdiction may formally comply with ATAD requirements while maintaining a relatively narrow and targeted CFC regime.

4.4 Luxembourg: Coordinating CFC Rules with International Tax Standards

Since 1 January 2019, Luxembourg tax law has incorporated CFC rules under the EU Anti-Tax Avoidance Directive. Luxembourg has opted for the transactional approach.

[131] Eleni Apostolidou, 'Controlled Foreign Company Legislation in Cyprus' in Georg Kofler and others (eds), *Controlled Foreign Company Legislation* (IBFD 2020), 207–219.
[132] OECD, *Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two)* (OECD 2021) https://www.oecd.org/content/dam/oecd/en/publications/reports/2021/12/tax-challenges-arising-from-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two_eed81a23/782bac33-en.pdf accessed 13 May 2026; Council Directive (EU) 2022/2523 of 14 December 2022; Council Directive (EU) 2016/1164.

Accordingly, Article 164ter of the Luxembourg Income Tax Law (LITL) – Law of December 4, 1967, on Income Tax (as amended)[133] was introduced, under which non-distributed income of a controlled foreign entity or permanent establishment is included in the tax base of the Luxembourg taxpayer, but only to the extent that such income arises from arrangements put in place primarily to obtain a tax advantage. In practical terms, the inclusion of CFC income is limited to situations where the relevant income-generating activities are effectively managed by the Luxembourg controlling entity. This is assessed by reference to the location of significant people functions, meaning that income is attributed to Luxembourg only insofar as these functions are performed by the Luxembourg taxpayer.[134]

The application of the regime further depends on whether the foreign entity or permanent establishment qualifies as a CFC. This requires the fulfilment of two cumulative conditions. First, the Luxembourg taxpayer must satisfy the control test, typically defined as holding more than 50% of the voting rights, capital, or profit entitlement. Second, the effective tax rate test is met when the foreign entity is a subject to low taxation, which is determined by comparing the tax actually paid with the tax that would have been due in Luxembourg. In essence, the CFC rules apply where the effective tax rate on the foreign entity is below approximately 50% of the Luxembourg corporate income tax burden.[135] The Luxembourg CFC rules apply exclusively for corporate income tax purposes and do not extend to municipal business tax. Consequently, any income included under the CFC regime is taxed at the standard Luxembourg corporate income tax rate.[136] Where both conditions are met, the Luxembourg taxpayer is required to include in its tax base the non-distributed income of the CFC, but only to the extent that such income arises from non-genuine arrangements. The inclusion is further limited to income attributable to assets and risks connected with significant people functions performed by the Luxembourg taxpayer.[137]

The regime also provides for certain exclusions. In particular, entities with limited economic significance are excluded, for example, where accounting profits do not exceed EUR

[133] Loi du 4 décembre 1967 concernant l'impôt sur le revenu, as amended.
[134] Oliver R Hoor and Jean-Philippe Andrieux, 'Luxembourg Implements the Anti-Tax Avoidance Directive (ATAD)' https://www.lexgo.be/en/news-and-articles/5635-luxembourg-implements-the-anti-tax-avoidance-directive-atad accessed 10 May 2026.
[135] Art. 164ter. (1) LITL.
[136] Oliver R Hoor and Jean-Philippe Andrieux, 'Luxembourg Implements the Anti-Tax Avoidance Directive (ATAD)' https://www.lexgo.be/en/news-and-articles/5635-luxembourg-implements-the-anti-tax-avoidance-directive-atad accessed 10 May 2026.
[137] PwC, 'Luxembourg: Corporate – Group Taxation' *Worldwide Tax Summaries* (13 January 2026) https://taxsummaries.pwc.com/luxembourg/corporate/group-taxation accessed 11 May 2026.

750,000 or where profits represent no more than 10% of operating costs.[138] The amount of income to be included in the tax base is determined in accordance with the arm's length principle and is limited to income attributable to assets and risks linked to the significant functions performed by the Luxembourg taxpayer. The inclusion is proportionate to the taxpayer's participation and is recognised in the tax period corresponding to the financial year of the CFC. To mitigate double taxation, Luxembourg provides several mechanisms.[139] Previously taxed income is excluded from taxation upon subsequent distribution, and similar adjustments apply in the case of disposals. In addition, foreign taxes paid by the CFC may be credited against the Luxembourg tax liability in proportion to the taxpayer's participation.[140]

The interaction between Luxembourg's CFC regime and the Pillar Two framework gives rise to both structural tensions and areas of overlap, reflecting their differing underlying policy objectives. The Luxembourg CFC regime incorporates a substance-based exemption, under which entities carrying out genuine economic activities supported by adequate staff, assets and premises may fall outside the scope of the rules. By contrast, the Pillar Two framework adopts a fundamentally different methodology, relying on a jurisdictional effective tax rate test that operates independently of economic substance, except to a limited extent through the GloBE substance-based income exclusion. This conceptual divergence may place jurisdictions such as Luxembourg at a relative disadvantage, given their reliance on substance-based criteria as a primary compliance filter. More broadly, it reveals an inherent tension between Luxembourg's tax system, traditionally grounded in principles of legal certainty, neutrality and alignment with economic reality and the more formulaic structure of Pillar Two.

In this respect, Luxembourg provides perhaps the clearest example of the broader shift identified throughout this thesis. Whereas traditional CFC regimes and the CJEU's abuse jurisprudence focus primarily on the existence of genuine economic activity, Pillar Two increasingly prioritises effective taxation as the decisive criterion. The Luxembourg experience therefore, illustrates the growing tension between substance-based taxation and minimum taxation within the contemporary international tax framework.

In particular, this divergence creates a risk of overlapping taxation. Income that is excluded from the scope of the Luxembourg CFC regime due to the presence of genuine

[138] Art. 164ter. (1) (a), (b) LITL.
[139] Art. 164ter. (1) 8. in accordance with the Art. 134bis and 134ter LITL.
[140] Oliver R Hoor and Jean-Philippe Andrieux, 'Luxembourg Implements the Anti-Tax Avoidance Directive (ATAD)' https://www.lexgo.be/en/news-and-articles/5635-luxembourg-implements-the-anti-tax-avoidance-directive-atad accessed 10 May 2026.

economic activity may nevertheless be subject to a top-up tax under Pillar Two if the relevant jurisdictional effective tax rate falls below the 15% threshold. Conversely, income included under the CFC regime may still be taken into account for Pillar Two purposes, potentially leading to cumulative taxation. Such outcomes raise concerns about over-taxation and may call into question the compatibility of the combined application of the two regimes with the principles of the EU internal market, particularly where uniform minimum tax thresholds are applied without regard to the underlying legal and economic context.[141]

4.5 Comparative Findings

The comparative analysis demonstrates that, despite the harmonising effect of the ATAD, significant differences remain in the design and application of CFC regimes across the selected Member States. While all four jurisdictions implement the common control and low-taxation requirements prescribed by the Directive, considerable divergence persists with respect to the determination of attributable income, the assessment of economic substance and the practical operation of anti-avoidance mechanisms. A first point of divergence concerns the choice of CFC model. Austria applies the category-based approach under Article 7(2)(a) ATAD, whereas Slovakia, Cyprus and Luxembourg have adopted variants of the transactional approach under Article 7(2)(b). As a result, the analysed jurisdictions differ not only in the scope of income subject to inclusion but also in the manner in which abuse and economic substance are assessed. Whereas the Austrian regime relies on predefined categories of passive income combined with a substance carve-out, the remaining jurisdictions place greater emphasis on the identification of non-genuine arrangements through a functional analysis of assets, risks and decision-making functions. These differences are particularly visible in the treatment of economic substance. Although all four regimes seek to distinguish genuine economic activity from artificial arrangements, they do so through different legal and administrative mechanisms. The findings therefore suggest that, notwithstanding the common framework established by the ATAD and the underlying principles derived from the case law of the Court of Justice of the European Union, no uniform understanding of substance has emerged at Member State level. The analysis further demonstrates differing approaches to the interaction between CFC rules and Pillar Two. While all four jurisdictions have implemented

[141] Konstantia-Angeliki Tampakoudi, 'Pillar Two and the Fundamental Freedoms: Evaluating Luxembourg's Corporate Tax Framework in Light of EU Law' (2025) *European Taxation,* 418.

the global minimum tax framework, the degree of coordination between existing CFC regimes and Pillar Two varies considerably. This reflects the broader challenge of integrating traditional anti-abuse measures with a new system of minimum taxation that pursues similar objectives through a different conceptual framework. Taken together, the findings indicate that the ATAD has achieved only partial harmonisation of CFC regimes within the European Union. At the same time, Pillar Two has not replaced national CFC rules. Instead, both regimes currently operate in parallel, creating a layered anti-avoidance framework in which questions of substance, proportionality, coherence and potential regulatory overlap become increasingly relevant. The coexistence of these instruments therefore raises broader questions concerning the future design of EU anti-avoidance rules, which are addressed in the following section on systemic coherence and regulatory decluttering.[142]

4.6 Systemic Coherence, Redundancy and Decluttering

The interaction between CFC regimes and the GloBE framework has given rise to an ongoing debate in the literature, particularly in light of the functional similarities between traditional CFC rules and the Income Inclusion Rule. While some commentators advocate for the abolition or reduction of CFC regimes on the grounds of redundancy, others argue that no comprehensive reform is required. On this basis, it has been suggested that the coexistence of both regimes may be justified, as they differ not only in their underlying rationale but also in their scope and practical effects. This position has also been reflected at the EU level, where the European Commission has indicated that the continued application of ATAD CFC rules alongside the GloBE framework does not necessarily require legislative amendment. Accordingly, the interaction between the two regimes is, to a large extent, left to their ordering and coordination in practice, including mechanisms such as the sequencing of rules and the allocation of taxing rights.[143]

Although both regimes pursue the common objective of countering base erosion and profit shifting, they are grounded in distinct conceptual logics: CFC rules reflect a targeted anti-abuse approach based on identifying non-genuine arrangements, whereas Pillar Two introduces a systemic minimum-taxation mechanism based on jurisdictional effective tax rates.[144] Against

[142] See Sections 4.1– 4.4 above.
[143] Georg Kofler, 'The "Decluttering" of EU Direct Tax Law' (2025) *EC Tax Review* 5–6.
[144] Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices [2016] OJ L 193/1; OECD, *Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion*

this background, the coexistence of these instruments raises fundamental questions of proportionality, necessity and efficiency within the EU legal order. In particular, it must be assessed whether the layering of multiple anti-avoidance measures results in a coherent and effective framework or instead generates excessive complexity and risks of cumulative taxation.[145] These concerns are increasingly reflected in contemporary EU policy discussions, which emphasise simplification and competitiveness. In this context, it is necessary to evaluate whether traditional CFC regimes retain an independent function or whether their relevance is gradually diminished by the emergence of a comprehensive minimum tax framework, thereby supporting arguments for regulatory decluttering within the EU tax system. In practice, companies falling within the scope of both the ATAD and the Minimum Taxation Directive may be subject to a cumulative application of CFC rules and Pillar Two. In such cases, the income of a controlled foreign entity may first be included in the tax base of the parent company under ATAD-compliant CFC rules and subsequently be subjected to a top-up tax under Pillar Two, despite the fact that the issue of low taxation has already been addressed at the level of the CFC regime. This sequential application gives rise to the risk of economic double taxation.[146] In light of these concerns, it has been argued in the literature that the continued application of ATAD CFC rules to entities within the scope of Pillar Two may no longer be justified. Proposals have therefore been advanced either to remove CFC rules from the ATAD framework altogether or, alternatively, to limit their application to entities falling outside the scope of the Minimum Taxation Directive.

The debate on regulatory decluttering extends beyond the OECD and the EU and is increasingly reflected in national reforms.[147] For instance, Germany, in response to the introduction of Pillar Two, has adjusted its CFC regime by lowering the low-tax threshold from 25% to 15%, thereby aligning it with the global minimum tax standard.[148] This reform, effective

Model Rules (Pillar Two) (OECD 2021) https://www.oecd.org/content/dam/oecd/en/publications/reports/2021/12/tax-challenges-arising-from-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two_eed81a23/782bac33-en.pdf accessed 13 May 2026.

[145] B J Arnold, 'An Investigation into the Interaction of CFC Rules and the OECD Pillar Two Global Minimum Tax' (2022) 76 *Bulletin for International Taxation* No 6; OECD, *Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two)* (February 2023) https://www.oecd.org/content/dam/oecd/en/topics/policy-sub-issues/global-minimum-tax/agreed-administrative-guidance-for-the-pillar-two-globe-rules.pdf accessed 10 May 2026.

[146] Jasper Korving, 'Concurrence of EU Direct Tax Directives: Hierarchy of Norms, Interpretational Solutions, or Decluttering?' (2026) 54(4) *Intertax,* 10–11.

[147] European Commission, *Business Taxation for the 21st Century* COM(2021) 251 final https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex:52021DC0251 accessed 12 May 2026.

[148] §8(5) of the German Foreign Tax Act, as amended by the Gesetz zur Umsetzung der Richtlinie (EU) 2022/2523 des Rates zur Gewährleistung einer globalen Mindestbesteuerung und wei- terer Begleitmaßnahmen, BGBl I 2023, Nr. 397, and BT- Drucksache 20/866, 239, 6 Oct. 2023.

from 2024, illustrates a broader trend towards recalibrating existing anti-avoidance rules in light of the emerging minimum taxation framework.[149] Such developments suggest a gradual shift from layered anti-avoidance mechanisms towards a more streamlined and coordinated system of corporate taxation.[150] In this context, the continued coexistence of CFC rules and Pillar Two raises the question of whether maintaining parallel regimes remains justified, particularly where both instruments target similar risks through different conceptual approaches.[151] While CFC rules retain a role as targeted anti-abuse measures, their functional overlap with Pillar Two may support arguments for their partial redesign or simplification. This lends weight to the view that a process of regulatory decluttering may be necessary to enhance coherence, reduce administrative complexity and ensure proportionality within the evolving EU tax framework.[152]

Ultimately, this raises the broader question whether CFC rules should be retained as an independent instrument or progressively integrated into a minimum tax-based framework. In particular, it has been argued that the introduction of Pillar Two has rendered certain ATAD provisions functionally redundant for in-scope entities. The simultaneous application of ATAD measures, such as CFC rules, interest limitation rules and the general anti-abuse rule, alongside the Minimum Taxation Directive, has been criticised for generating excessive complexity, increasing administrative burdens and potentially undermining the coherence of the overall EU tax framework. In this context, several stakeholders, including professional and business organisations[153], have called for a process of regulatory decluttering. In particular, proposals have been advanced urging the European Commission to exempt entities subject to the Minimum Taxation Directive from overlapping ATAD provisions, to promote greater consistency in the implementation of ATAD across Member States, and to streamline the broader corporate tax framework with a view to enhancing competitiveness and reducing unnecessary compliance costs.[154]

Finally, further rationalisation of the EU anti-avoidance framework could be achieved by reconsidering certain structural features of the ATAD, in particular the continued reliance on the transactional approach to determining CFC income (Model B). Given its significant

[149] Shu-Yi Oei and Diane M Ring, 'Global Tax Decluttering' (Working Draft, 16 March 2025).
[150] European Commission, *Annual Report on Taxation 2023* (Publications Office of the European Union 2023).
[151] B J Arnold, 'An Investigation into the Interaction of CFC Rules and the OECD Pillar Two Global Minimum Tax' (2022) 76 *Bulletin for International Taxation* No 6.
[152] OECD, *Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two)* (OECD 2021) https://www.oecd.org/content/dam/oecd/en/publications/reports/2021/12/tax-challenges-arising-from-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two_eed81a23/782bac33-en.pdf accessed 13 May 2026.
[153] E.g. CFE Tax Advisers Europe and AmCham EU.
[154] Oana Popa, 'Navigating the Complexity of EU Rules in Direct Taxation: Legislative Clutter, Institutional Initiatives and Steps Toward a Sustainable Framework' (2026) 66 *European Taxation,* 6.

overlap with the proper application of transfer pricing rules to intra-group transactions, the added value of this approach appears increasingly limited. A targeted revision of the CFC regime could therefore focus on simplifying key elements, including the low-tax threshold and the mechanisms for attributing CFC income, while addressing persistent concerns about unrelieved double taxation. More broadly, beyond the design of individual rules, a major source of complexity arises from the fragmented implementation of ATAD across Member States. The Directive allows for multiple policy choices, such as alternative CFC models or variations in interest limitation rules, which have resulted in divergent national approaches. This fragmentation is further exacerbated by the absence of consistent interpretative guidance, leading to differences in the application of core concepts by national tax authorities. As a consequence, businesses operating within the internal market face increased compliance burdens and legal uncertainty, while the objective of ensuring a level playing field across the EU is only partially achieved. In this context, Pillar Two further strengthens the case for a more coordinated and streamlined approach to EU corporate taxation, capable of reducing fragmentation while preserving the effectiveness of anti-avoidance measures.[155]

4.7 Towards a More Coherent EU Anti-Avoidance Framework

The comparative analysis of Austria, Slovakia, Cyprus and Luxembourg demonstrates that the practical operation of CFC regimes remains significantly fragmented despite the harmonising ambitions of the ATAD. The comparative findings outlined above provide a basis for broader normative reflections on the future design of the EU anti-avoidance framework. Against the background of the increasing overlap between CFC regimes and the Pillar Two framework, the question of regulatory simplification becomes particularly salient within the EU corporate tax landscape. The analysis undertaken in this thesis suggests that the coexistence of multiple anti-avoidance instruments, while originally justified by distinct policy objectives, now gives rise to structural tensions, duplication and increased compliance burdens across Member States. In particular, the layered application of CFC rules and the GloBE top-up tax may lead to cumulative taxation of the same income, without adequately distinguishing between artificial arrangements and genuine economic activity. In this context, a gradual recalibration of the EU anti-avoidance framework appears warranted. First, Member States should consider

[155] Francesco De Lillo, 'The Future of EU Anti-Avoidance Tax Rules, Including Simplification' (Statement, EU Parliament FISC Committee, 15 May 2025) 1–3.

enhancing the coordination between CFC regimes and Pillar Two, for instance, by introducing mechanisms that mitigate overlapping taxation, such as partial tax credits or aligned safe harbour provisions. Second, greater emphasis should be placed on incorporating substance-sensitive elements into the application of minimum taxation rules, allowing for a more nuanced differentiation between low-tax outcomes arising from abusive structures and those resulting from legitimate economic activity. Furthermore, simplification efforts at the EU level could focus on limiting the application of CFC rules to situations not effectively addressed by the Pillar Two framework, thereby reducing redundancy while preserving their targeted anti-abuse function. Such an approach would be consistent with broader policy discussions on decluttering the EU tax system and would contribute to enhancing legal certainty and administrative efficiency within the internal market. Finally, ensuring compliance with EU primary law requires that the combined operation of CFC rules and Pillar Two respects the principles of proportionality and equal treatment. This may necessitate the introduction of procedural safeguards, including review mechanisms or rebuttal opportunities, particularly in cases involving genuine cross-border economic activity. Overall, a more coordinated and streamlined approach to the interaction of these regimes would strengthen the coherence of the EU corporate tax framework while maintaining its effectiveness in addressing base erosion and profit shifting.[156]

The findings of the comparative analysis largely confirm that, despite the harmonising ambitions of the ATAD, Member States continue to apply materially different approaches to economic substance, income attribution and the interaction between CFC rules and Pillar Two. These divergences provide the basis for the concluding assessment of whether the current framework constitutes a coherent and proportionate anti-avoidance architecture within the European Union.

[156] Konstantia-Angeliki Tampakoudi, 'Pillar Two and the Fundamental Freedoms: Evaluating Luxembourg's Corporate Tax Framework in Light of EU Law' (2025) *European Taxation,* 424–426.

Conclusion

This thesis set out to examine whether the interaction between CFC regimes and the OECD/G20 Pillar Two framework results in a coherent and proportionate anti-avoidance architecture within the European Union. By analysing the legal design, practical application and underlying rationale of CFC rules in Austria, Slovakia, Cyprus and Luxembourg and situating these regimes within the broader EU and international tax framework, the study has revealed a system characterised by both functional complementarity and structural tension.

A central finding of the analysis is that, despite formal harmonisation under the ATAD, Member States continue to apply materially divergent approaches to key elements of CFC regimes, particularly regarding control thresholds and the interpretation of economic substance. While jurisdictions such as Austria and Luxembourg have adopted relatively structured and ATAD-aligned frameworks incorporating substance-based limitations, other regimes, most notably Slovakia in specific contexts, demonstrate broader or less clearly delimited applications. Cyprus, as a traditionally low-tax jurisdiction, reflects yet another variation, where the interaction between low statutory taxation and substance considerations plays a distinct role. These differences confirm that, in practice, a uniform EU concept of abuse has not fully materialised, notwithstanding the guidance provided by the Court of Justice of the European Union.

At the same time, the analysis of the substance requirement across jurisdictions highlights a fundamental conceptual anchor of EU tax law: anti-avoidance measures must be limited to wholly artificial arrangements and must allow taxpayers to demonstrate the existence of genuine economic activity. This principle, developed in *Cadbury Schweppes* and subsequent case law, continues to shape the permissible scope of CFC regimes. In contrast, the Pillar Two framework departs from this logic by adopting a predominantly mechanical, rate-based approach, in which taxation is triggered by the level of effective taxation rather than by an assessment of abusive conduct. The resulting shift from a qualitative to a quantitative model constitutes a significant transformation in the architecture of international tax law.

Against this background, the thesis finds that Pillar Two does not replace the anti-deferral function of CFC regimes, but rather reduces and partially complements it. While the GloBE framework is effective in addressing low-tax outcomes on a systemic level, it does not fully capture the nuanced distinction between artificial and genuine arrangements that lies at the core of EU anti-abuse doctrine. As a result, CFC rules retain a residual function, particularly in addressing scenarios where legal form and economic reality diverge. This finding confirms the first hypothesis and demonstrates that the continued relevance of CFC regimes is increasingly context dependent.

However, the coexistence of these regimes also poses significant challenges. The analysis has shown that, in practice, the sequential application of CFC rules and Pillar Two may lead to overlapping taxation of the same income, especially in cases involving low-taxed subsidiaries within multinational group structures. This creates risks of economic double taxation and contributes to increased administrative complexity, thereby supporting the hypothesis that the current framework entails a degree of regulatory redundancy. These effects are further exacerbated by the fragmented implementation of ATAD across Member States and the absence of a consistent approach to key concepts such as substance and effective taxation.
From an EU law perspective, these developments raise important concerns regarding proportionality and equal treatment. The automatic operation of the Pillar Two top-up tax, combined with the absence of a meaningful rebuttal mechanism, may result in the taxation of income derived from genuine economic activity, thereby potentially exceeding what is necessary to achieve the objective of combating tax avoidance. In light of the case law of the Court of Justice, which requires that restrictive tax measures be both targeted and proportionate, this creates a structural tension between the design of the GloBE framework and the constitutional principles of the EU internal market. Taken together, these findings suggest that the current interaction between CFC regimes and Pillar Two does not yet constitute a fully coherent and proportionate anti-avoidance framework. While both instruments pursue legitimate and, to a certain extent, complementary objectives, their parallel application leads to overlaps, inconsistencies and legal uncertainty. This conclusion supports the hypothesis that the layered coexistence of traditional anti-avoidance rules and global minimum taxation gives rise to partial redundancy and calls for reconsideration at both the national and EU level.

In this context, the thesis identifies a need for a more coordinated and streamlined approach to the design of the EU corporate tax framework. This may involve limiting the application of CFC rules to situations not effectively addressed by Pillar Two, enhancing coordination mechanisms to prevent double taxation, and introducing greater sensitivity to economic substance within the operation of minimum taxation rules. Such reforms would not only reduce complexity and compliance burdens but also strengthen alignment with EU law principles, in particular proportionality, legal certainty and the protection of fundamental freedoms.

Ultimately, the evolution of the relationship between CFC regimes and Pillar Two reflects a broader shift in international tax governance from targeted anti-abuse rules towards systemic forms of minimum taxation. The extent to which these approaches can be reconciled within the EU legal order will be decisive for the future development of corporate taxation in the internal market.

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Abstract

This thesis examines the interaction between Controlled Foreign Company regimes and the OECD/G20 Pillar Two framework within the European Union, with particular focus on the role of economic substance. Through a comparative analysis of Austria, Slovakia, Cyprus and Luxembourg, it explores how national CFC regimes have been implemented and how they interact with the global minimum tax rules. The thesis analyses the development of CFC rules within the OECD Base Erosion and Profit Shifting Project and the Anti-Tax Avoidance Directive, as well as the limitations imposed by EU primary law. It subsequently assesses the concept of economic substance in EU law, with particular emphasis on the Cadbury Schweppes doctrine and its incorporation into the ATAD framework. Particular attention is given to the role of substance within the Global Anti-Base Erosion Rules, together with its relevance in the EU legal context. Building on this foundation, the thesis considers whether the coexistence of CFC regimes and Pillar Two forms a coherent anti-avoidance framework and discusses broader questions relating to proportionality, legal certainty and regulatory overlap within EU corporate taxation.

Keywords: CFC rules; Pillar II; global minimum tax; GloBE; substance requirements; ATAD; EU tax law; proportionality; tax avoidance; regulatory coherence; decluttering; effective tax rate; multinational enterprises

Zusammenfassung

Diese Thesis untersucht das Zusammenspiel zwischen den Regelungen zu kontrollierten ausländischen Unternehmen und dem Rahmenwerk der Pillar-II-Regelungen innerhalb der Europäischen Union. Anhand einer vergleichenden Analyse von Österreich, der Slowakei, Zypern und Luxemburg wird untersucht, wie nationale CFC-Regelungen umgesetzt wurden und wie diese mit den globalen Mindeststeuerregeln interagieren. Zentraler Bestandteil dieser Thesis ist zudem die Analyse der Entwicklung der CFC-Regeln im Rahmen des OECD-Projekts zur Bekämpfung von Gewinnverkürzung und -verlagerung (BEPS) sowie der ATAD-Richtlinie zur Bekämpfung von Steuervermeidung und der durch das EU-Primärrecht auferlegten Beschränkungen. Ein weiterer Schwerpunkt liegt auf der Analyse von Substanzanforderungen, welche ein wesentliches Kriterium zur Abgrenzung von steuerlich aggressiven bzw. wirtschaftlich begründeten Strukturen darstellen. Dieses Thema wird unter anderem anhand der Cadbury-Schweppes-Doktrin und ihrer Einbeziehung in den ATAD-Rahmen bewertet. Ebenso wird die Beurteilung der wirtschaftlichen Substanz anhand der Global Anti-Base Erosion (GloBE)-Regeln sowie ihrer Relevanz im rechtlichen Kontext der EU beurteilt. Auf dieser Grundlage untersucht die vorliegende Thesis, ob die Koexistenz von CFC-Regelungen und Pillar-II einen kohärenten Rahmen zur Bekämpfung von Steuerumgehungen bilden. Darüber hinaus werden Fragen der Verhältnismäßigkeit, der Rechtssicherheit sowie möglicher regulatorischer Überschneidungen im Bereich der EU-Unternehmensbesteuerung untersucht.

Schlüsselwörter: CFC-Regeln; Pillar II; globale Mindestbesteuerung; GloBE; Substanzanforderungen; ATAD; EU-Steuerrecht; Verhältnismäßigkeit; Steuervermeidung; systematische Kohärenz; Vereinfachung des Steuerrechts; effektive Steuerbelastung; multinationale Unternehmen