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Taxing the Digital Economy

A Legal Assessment of the
Introduction of Pillar One to the Internal Market

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Summary

In the last decade, the progress of the digital economy has caused a rift in the international tax regime, which now faces several challenges. The current principles governing taxation rules are based on notions that business can only be conducted through physical presence. Consequently, these principles have been pushed to their edge as present-day enterprises have found new ways to conduct businesses without the need of a physical presence in the market jurisdiction. According to the current rules of international taxation, an enterprise is only liable for tax in a state where it has a certain degree of physical presence otherwise it is only liable for taxation in its residence state, or a state where the enterprise has a permanent establishment. The current rules create an opportunity for aggressive tax planning schemes and tax evasion which enterprises are willing to utilize. To address these pressing issues the OECD has presented two proposals, Pillar One and Pillar Two, on how the digital economy could be taxed and the changes which would have to be made.

The purpose of this thesis is to examine the legal possibilities of the introduction of OECD's Pillar One into European Union law through a directive. Pillar One's compatibility with some primary rules and principles of Union law are analysed, mainly the fundamental freedoms, articles 18 and 115 TFEU, and the principles of subsidiarity and proportionality.

The primary conclusion that can be drawn from this thesis is that such a directive would face an uphill battle, even though it would be the most plausible way for the EU member states to fulfill their commitments within the OECD. Because of the way the scope of Pillar One is determined, based on a global turnover base, it cannot constitute direct discrimination through its objective criterion. However, it is up to the CJEU to decide as they could change the conclusion by applying the majority rule which would determine that Pillar One is discriminatory. Furthermore, examined against the other

fundamental freedoms and especially the freedom of establishment, it can be concluded that Pillar One would not impede the freedoms even if arguments can be made for both sides.

In the way the framework is presented in the updated version of Pillar One it would not go beyond what is necessary to achieve the desired goals. Consequently, the principle of proportionality would not be breached. The fact that tax avoidance and evasion are global issues, which are unlikely solved by unilateral measures, it is more convenient for the European countries to accept a directive on the field of direct taxation. Furthermore, it would create a cohesive implementation that would strengthen the EU’s position as a strong economic actor. Therefore, it can be concluded that a directive on Pillar One would be in accordance with the principle of subsidiarity. As for the unanimity requirement in article 115 TFEU, it remains to be seen if the European countries can set their differences aside and agree on the proposal.

Sammanfattning

Under det senaste decenniet har den digitala ekonomins framfart orsakat en spricka i de internationella företagsbeskattningsreglerna, vilka numera står inför ett antal utmaningar. De nuvarande principerna för företagsbeskattning bygger på föreställningen att verksamhet endast kan bedrivas genom en fysisk närvaro. Följaktligen har dessa principer drivits till sin spets när dagens företag har hittat nya sätt att bedriva verksamhet på utan ett behov av fysisk närvaro i marknadsjurisdiktionen. Enligt nuvarande regler för internationell företagsbeskattning är ett företag endast skattskyldigt i en stat om företaget har en viss fysisk närvaro där, annars är det endast skattskyldigt i sin hemviststat. De nuvarande reglerna skapar en möjlighet för aggressiv skatteplanering och skatteflykt, vilket vissa företag är villiga att utnyttja. För att ta itu med dessa problem har OECD lagt fram två förslag, Pelare Ett och Pelare Två, om hur den digitala ekonomin skulle kunna beskattas och de förändringar som är nödvändiga att göra för att problemen digitaliseringen har medfört ska dämpas och potentiellt helt försvinna.

Syftet med denna avhandling är att undersöka de juridiska möjligheterna att införa Pelare Ett i unionsrätten genom ett direktiv. Den första pelarens förenlighet med relevanta EU-rättsliga regler och principer analyseras, främst art. 18 och 115 FEUF, de grundläggande friheterna samt subsidiaritets- och proportionalitetsprinciperna.

En av slutsatserna som kan dras av denna avhandling är att ett sådant direktiv skulle stå inför en rad utmaningar, även om det skulle vara det mest rimliga sättet för EU:s medlemsländer att uppfylla sina åtaganden inom OECD. Med beaktande av att omfattningen av Pelare Ett bestäms utifrån en global omsättningsbas, kan kriteriet inte utgöra direkt diskriminering eftersom det är objektivt utformat. Det är dock upp till EUD att besluta i denna fråga, eftersom en tillämpning av majoritetsregeln framtagen i Hervis

Sport domen hade medfört att Pelare Ett uppfyllt kriteriet och därmed varit diskriminerande. Vidare kan man, granskat mot de grundläggande friheterna och särskilt etableringsfriheten, konstatera att Pelare Ett inte skulle hindra utövandet av friheterna som FEUF garanterar EU:s medborgare.

Slutligen, på det sättet som ramverket för Pelare Ett presenteras i den senaste versionen från OECD, skulle ett direktiv inte gå längre än nödvändigt för att uppnå målen med lagstiftningen. Därmed skulle proportionalitetsprincipen inte åsidosättas. Faktumet att skatteundandragande och skatteflykt är globala problem, medför att det är osannolikt att problemen skulle kunna lösas genom ensidiga åtgärder. Ett direktiv på det direkta beskattningsområdet skulle vara mer lämpligt eftersom området hade harmoniserats i det avseendet och det skulle vidare stärka EU:s ställning som en stark internationell aktör. Därför kan man dra slutsatsen att ett direktiv som genomför regeländringarna som Pelare Ett föreslår, skulle vara förenligt med subsidiaritetsprincipen. När det gäller kravet på enhällighet i art. 115 FEUF, återstår det att se om de europeiska länderna kan lägga sina meningsskiljaktigheter åt sidan och enas om förslaget.

Preface

It is with equal parts melancholy and joy that I hereby declare my four-and-a-half-year journey on the Masters of Laws program at Lund University, as completed. This journey has been a roller-coaster ride to remember, with both ups and downs, although mostly ups. With this in mind, I would like to take this opportunity and thank some well-chosen people.

I would like to begin by thanking my supervisor *Richard Croneberg*, for all the valuable conversations, reflections, and support you have given. This thesis would not have been the same without your help.

Secondly, I would like to thank all my amazing *friends* who have been there for me in wet and dry. Thank you for making these years unforgettable. No one mentioned, no one forgotten – you know who you are. You are worth gold!

Finally, a special thank you to my *family* for always believing in me and my ability. *Mom and Dad*, thank you for your patience with my constant complaining and self-doubt, your support has been a big reason why I managed to complete the studies and above all, this thesis. *Austeja,* thank you for giving me pep-talks and always making me laugh, even when I am feeling the most down. Without you, I would not be where I am today.

Lund, January 3rd 2022
Gabija Ramanauskaite

Abbreviations

ADS	Automated Digital Services
BEPS	Base Erosion and Profit Shifting
CbCR	Country-by-Country Reports
CFB	Consumer-Facing Business
CFC	Controlled Foreign Company
CJEU	Court of Justice of the European Union
DTA	Double Tax Agreement
EU	European Union
FEU	The Treaty of the European Union
G20	Group of Twenty Finance Ministers and Central Bank Governors
GST	Goods and Services Tax
IF	Inclusive Framework
ISP	Internet Service Provider
MNE	Multinational Enterprise
OECD	Organisation for Economic Cooperation and Development
OEEC	Organisation for European Economic Cooperation
PE	Permanent Establishment
TFEU	The Treaty of the Functioning of the European Union
VAT	Value Added Tax

1 Introduction

1.1 Background

The digitalization of the economy has created problems that cannot be solved by one sole state but must be addressed by the whole international community. The Organisation for Economic Cooperation and Development (OECD) has already presented the two-pillar solution that could successfully address the issues of digitalization; however, the question is, how will it be implemented and when?[1]

The French President Emmanuel Macron gave, on December 9th, an overview of the priorities France wants to pursue when it takes over the EU Council Presidency in the first half of 2022. Macron declared that they would promote the introduction of Pillar One and Two by the spring of 2022 and stated in his speech that action at state level was not the right way to go forward.[2] Benjamin Angel, director of direct taxation and tax coordination at the Commission, stated that the EU would want to quickly implement Pillar Two and stressed the importance of implementing the agreement at EU level. EU Commissioner Paolo Gentiloni expressed in a speech, that the EU will not spare any efforts to ensure that a directive on Pillar Two is adopted during the French Presidency. Gentiloni reminded once more about the investigations of OpenLux and Pandora Papers and withheld that everyone must pay their fair share of tax and that the digital transition can only

[1] See OECD, Blueprint – Pillar One & Two, 2020. To address the challenges created by the digitalization of the economy and the accompanied risks of base erosion and profit shifting, the OECD released two proposals for how the digital economy should be regulated in the future. In October 2020, The OECD released reports and blueprints of the proposals which were expected to be finalized in October 2021. The two proposals, Pillar One and Pillar two, include among other, the introduction of a new taxable nexus based on digital presence and the introduction of an equalization tax.

[2] Pollet, *France to prioritise digital regulation, tech sovereignty during EU Council presidency*, Fox (red.), Euractiv France, 14 December 2021. Macron also stated that France wants to complete the introduction of the Digital Markets Act and the Digital Service Act during its presidency and recalled that when the European countries work together, they can set standards on an international scale, referring to the General Data Protection Regulation.

happen if it is based on fairness, therefore the global corporate taxation rules have to be reset.[3]

The global economy as we know it today is characterized by technological innovations and digital services which allows multinational enterprises (MNE) to conduct business in multiple jurisdictions without having a physical presence there, i.e., a store or headquarters. The current international tax rules pose a challenge to the taxation of the digital economy as they require an MNE to have a physical presence in a market jurisdiction for the jurisdiction to have the right to tax the MNE, called the rule of permanent establishment (PE).[4] The current digital environment enables MNEs to operate without creating a physical taxable presence and use business models that challenge the notions of where and how value is created.[5]

The general provisions of OECD's proposal for a new digital nexus rely on the fact that the MNE has a turnover above certain threshold values for a taxable nexus to form in a country where the users of the MNEs are located. These threshold values are detailed and will therefore only apply to a small number of digital businesses, most notably, tech giants such as Google, Facebook, etc. Statistically, the headquarters of these tech giants are located outside of Europe, however, they usually have a subsidiary in low tax regimes, for example, Ireland or Luxemburg.[6] The new digital tax would

[3] See Ammann, *EU directive on minimum corporate tax expected before end of year*, Fox (red.), Euractiv.com, 14 October 2021 and Gentiloni, European Commission – Speech, Brussels, 22 December 2021. According to angel the EU executives could propose a directive as soon as the OECD publishes its model rules on the implementation of the equalization tax. Gentiloni called the adoption of the tax agreement "nothing less than a tax revolution".

[4] See OECD, Model Convention, 2017, Art. 5 and the Commentaries to the article. The general definition of a PE is established in Article 5.1 and is a result of a balance act between residence and source taxation as the main principle is that business profits are only taxable in the residence state, unless the enterprise has a PE in the source state. A PE is considered to exist if there is a fixed place of business through which the business of an enterprise is wholly or partly carried on.

[5] OECD, *Addressing the Tax Challenges of the Digital Economy*, (Paris: OECD, 2015), p. 98-101; UN, *Handbook on Selected Issues in Protecting the Tax Base of Developing Countries* (New York: UN, 2017) p. 501 and p. 504.

[6] Devereux & Simmler, *Who Will Pay Amount A?* in EconPol Policy Brief, No. 36, Munich, IFO Institute - Leibniz Institute for Economic Research at the University of Munich, 2021.

allow other countries to tax these MNE's accordingly. Since most MNEs that would be subject to this new taxable nexus are located in the US, with subsidiaries in Ireland or Luxemburg, there could be some issues regarding the prohibition of discrimination based on nationality and the freedom of establishment within EU-law.

The proposals have been a part of a heated debate and many question the impact an implementation of the proposals might have on the member states. Some critics have pointed out that Pillar One risks to disfavour smaller countries with a high degree of development and innovation and favours bigger market jurisdictions with a large quantity of consumers. Another concerning point is that the proposals might limit a state's sovereignty in the field of tax law by determining how the member states should reform their national tax systems. Even though the proposals on digital taxation might be controversial and the global field is divided into two teams everyone seems to agree that it is necessary to address the problems the digitalization of the economy has caused and that the current framework is not fit enough to do so.

1.2 Purpose and Research Questions

The main purpose of this thesis is to examine the legal possibilities to implement OECD's Pillar One into EU law through a directive. The implementation issue will be examined against art. 115 TFEU which requires unanimity as the EU does not have the competence to legislate in the field of direct taxation. Furthermore, this thesis examines Pillar One's compatibility with the principles of subsidiarity and proportionality, which are essential in the legislative process within the EU. Furthermore, the thesis examines the current framework of international corporate taxation and the challenges posed by the digitalization of the economy. Legislation cannot be adopted if it breaches or impedes the fundamental freedoms of the union, therefore an examination is made regarding the relationship between Pillar One and the fundamental freedoms.

The purpose of this thesis is divided into three phases, each phase has a research question relating to the different parts of the main purpose. The first research question identifies the applicable law in the field of direct taxation and the challenges the digitalization of the economy has brought forward:

- *What rules govern corporate income taxation and how are they challenged by digitalization?*

While the first question creates a framework of relevant laws and principles in the field of direct taxation and simultaneously exposes different challenges that have emerged through digitalization, the second question brings light to the reasons why an introduction of Pillar One into the Union might be a daunting task. The question will delve deeper into the legal challenges that exist in the introduction of a directive on the field of direct taxation in the Union. Through this phase of the study, the following question is answered:

- *How would a potential introduction of Pillar One comply with article 115 TFEU and the principles of subsidiarity and proportionality?*

As the second question answers why implementation of a directive has been a difficult task for the EU, the last question further answers the question, although in regards to the fundamental freedoms. This is done on the basis of the compatibility analysis of Pillar One against the fundamental freedoms established in the TFEU, which is examined through the following question:

- *Does OECD's proposal for a digital tax comply with existing primary union law as established in the TFEU, mainly the freedom of establishment?*

1.3 Method and Materials

In order to achieve the purpose of this thesis, two different methods will be used; the doctrinal approach and the European legal method.[7] The doctrinal approach seeks to collect and analyse a body of law through primary sources and case law. The analysis is usually not interested in what ought to be, but rather what the law is and identifying underlying principles based on which legal decisions are made. In addition to the primary sources, the doctrinal approach utilizes; secondary legislation, case law, legal doctrine, government reports, and consultations. The first part of the thesis will be conducted with the doctrinal approach to establish the existing relevant European Union law and the international tax law. As the first three chapters examine and address the existing rules and principles, the dogmatic approach seems most fit to use in this case. These chapters aim to give the reader an understanding of the historic evolvement and current legislation on the field of direct taxation and regarding the Union legislation, the rights given to the legal and natural bodies by the Treaties.[8]

The second chapter sheds light on the issues the digitalization has brought to the economy and the international taxation regime. The chapter discusses the different taxation rules and principles that have evolved and are based on the Model Convention.[9] The Model Convention is not commonly seen as a primary source of law but merely as a soft law instrument, hence, the doctrinal approach might not be the most suitable method. However, as the Model Convention is highly respected among states and they follow the convention to a high extent when conducting new bilateral tax treaties and most states accept the commentaries to the Model Convention as an interpretative instrument, it can be argued that concerning international tax

[7] See e.g., Reichel, *EU-rättslig metod*, in Juridisk metodlära, Nääv & Zamboni (red.), 2nd edition, Studentlitteratur, Lund, [2018] p. 109–127.The European Legal method is defined in this thesis in accordance with author Reichel.

[8] Smith, *What is Legal Doctrine? On the Aims and Methods of Legal-Dogmatic Research*, Maastricht European Private Law Institute Working Paper, 6th issue, 2015 p. 5-10.

[9] OECD, *Model Tax Convention on Income and on Capital: Condensed Version 2017*, Paris, OECD, 2017, p. 9. Hereinafter “OECD, Model Convention, 2017”.

law the materials, such as the Model Convention and the Commentaries, from the OECD are part of primary law.[10]

As the aim is to create a framework for the forthcoming analysis of the research questions, the descriptive parts of this thesis are focused on the aspect of legislation concerning the rights and obligations of corporations in the field of direct taxation. This chapter mainly uses the European legal method in conjunction with the doctrinal method. The fourth chapter takes a more individualistic perspective of corporations, it addresses the rights the Treaties give to individuals within the EU and how these rights have been utilized. Therefore, mainly primary sources of law will be used, such as the TEU, TFEU, and case law. Secondary legislation has also been mentioned to give a more in-depth overview of the historic and future developments on the field which will give the analysis a more reliable outlook.[11]

The last two chapters (chapters 4 and 5) utilize the European legal method and the doctrinal approach.[12] The European legal methodology can be described as the law in action, where the law constitutes an autonomous legal system in which the sources of EU law are divided into primary law, general legal principles, secondary law, and soft law. The main focus is usually the doctrines and case law that underpin particular legal phenomena and in contrast to the dogmatic approach, less focus is given to the language of the law.[13]

The symbiosis of the two methodologies can best be seen in the fourth chapter where the structure follows a more descriptive approach but the materials are utilized according to the European legal method. The doctrinal approach, applied in this thesis has a broader range of materials and utilizes soft law materials due to the purpose of the thesis. The Blueprint of Pillar

[10] Smith, 2015, p. 8-16.
[11] Reichel, Nääv & Zamboni, 2019, p. 109–121.
[12] Reichel, Nääv & Zamboni, 2019, p. 109–127.
[13] See e.g., Streiz, *Interpretation and development of EU primary law*, in European Legal Methodology, Intersentia, Cambridge, 2017, p. 160-165.

One cannot be seen as a source of primary law as it is not yet adopted and even afterward, it would be a soft law instrument until states decided to implement the proposal into their domestic legislation. Consequently, the doctrinal approach would be insufficient, not taking into consideration the soft law aspects that allow the use of reports from NGOs, different stakeholders, and empirical research. The use of both of these methodologies allows for a more in-depth examination of Pillar One and the legal framework of the EU field of direct taxation.[14]

The analysis combines the descriptive approach and the European legal methodology. The reason for this is that the descriptive chapters are analysed with the aim to evaluate the proposal of Pillar One and its compatibility with Union law. The European legal method allows us to see the European legal field as a cohesive system dependent on the different legal documents and case law.

1.4 State of Research

Taxation of the digital economy is a fairly new phenomenon and therefore not widely explored. Furthermore, the OECD's draft proposal concerning Pillar One and Pillar Two was presented in October 2020. Therefore, most of the material available consists of articles that either aim to explain the content of the proposals and the work remaining or articles of a more critical nature. Regarding issues concerning the principles of international taxation, the legal source value of OECD's material, and the concept of a permanent establishment, this has previously been dealt with in multiple published books, essays, and articles. Material that deals with permanent establishment and physical establishment is primarily characterized by the

[14] See e.g., Streiz, 2017 and Nielsen, *Towards an Interactive Comparative Method for Studying the Multi-Layered EU Legal Order*, in European Legal Method – a Multi-Level EU Legal Order, Neergaard & Nielsen (red.), DJOF Publishing, Copenhagen, 2012, p. 91-93.

works of Skaar, who to some extent touches on this concept in relation to the digital economy.[15]

The relation between Pillar One and the fundamental freedoms of the EU has been accounted for in multiple articles.[16] Furthermore, the concept of digital taxation has risen in popularity with students as a large number of essays has been written about some aspect of digital taxation both from the perspective of the EU, OECD's and UN perspective.[17] However, none of them have dealt with the potential issues of the forthcoming implementation process of Pillar One in the EU. Thus, this thesis differs from previous research made in this field.

1.5 Delimitations

As a result of the thesis's formulated purpose and research questions, certain delimitations have been necessary. The main focus of this study is to examine the proposal from OECD concerning the new rules for taxation of digital activities. The proposal is considered as a package where both Pillar One and Two will create a new playing field for digital businesses. However, in consideration of the purpose of this thesis and the vast amount of material, the study has been limited to only focus on Pillar One. Consequently, other proposals on the matter have not been examined in detail, although, the proposal from the EU has been mentioned and accounted for in a more general way to give the analysis a better ground.

[15] Skaar, *Permanent Establishment: Erosion of a Tax Treaty Principle*, 2ed Edition, Alphen aan den Rijn: Wolters Kluwer, 2020.

[16] See e.g., Englisch, *Designing a Harmonized EU-GloBE in Compliance with Fundamental Freedoms,*in the EC Tax Review, Vol. 30, issue 3, 2021; Forsgren, Song & Horváth, *Digital Services Taxes: Do They Comply with International Tax, Trade, and EU Law?* ,2020; Bammens, *The principle of non-discrimination in international and European tax law,*IBDF, Diss. Leuven: Katholieke Universiteit Leuven , 2011, Amsterdam, [2012].

[17] See Gustafsson, *Beskattning av den digitala ekonomin: Kan OECD leda vägen framåt?* Lund, 2021, Hadzovic, *Taxing the Digital Economy in Developing Countries*, Lund, 2021 and Weibull, *Ett virtuellt nexus: En granskning av tillämpningen av en omsättningsbaserad skatt för multinationella företag i ljuset av EU:s fria rörligheter*, Lund, 2021.

Further delimitations have been made regarding Pillar One itself, as it consists of three mechanisms, Amount A, Amount B, and Tax certainty (Amount C), the focus will only lie on Amount A since it is through Amount A that a new nexus is presented. The other two mechanisms will only be briefly mentioned. Because Pillar One only deals with legal bodies in the form of MNEs, branches, and subsidiaries, it is a natural consequence that the study has been limited to materials regulating the relationship between states and enterprises. Furthermore, as the proposal and the thesis refer to the field of direct taxation, the area of indirect taxation such as the VAT rules are left out.

As the proposal on Pillar One is comprehensive in terms of its content, and the main issue of the thesis is to examine its compatibility with Union law, only key aspects of Pillar One are examined, such as the scope, nexus, and implementation. Union law will be limited to only examining the general prohibition of discrimination and the freedom of establishment as these provisions have the biggest impact on Pillar One and its compatibility with Union law. The other fundamental freedoms are presented and a discussion is held in accordance with the case-law of the CJEU's restriction analysis but the thesis will not go into detail on every freedom. In addition to the discrimination and restriction analysis, the issue of implementation will deal with three main problems, the art. 115 TFEU, the principle of subsidiarity and the principle of proportionality. Other issues that might arise in the implementation process have been left out due to the scope of the study.

Lastly, the rules on state aid and protectionist tax are excluded from the thesis but would have been of interest as issues concerning Pillar One could potentially occur if Pillar One is implemented. Furthermore, as the aim of this thesis is to evaluate the potential introduction of Pillar One into the Union law through a directive, the implementation of Pillar One through the multilateral instrument, which is proposed by the OECD, is not discussed.

1.6 Outline

The first chapter presents the purpose of the thesis, the research questions, the method, etc. The second chapter presents an overview of the issues the international corporate tax regime is facing. The chapter discusses the competing demands of source and resident taxation, the issues of digitalization, and the background to the topic of the third chapter which concerns Pillar One. As mentioned, the third chapter addresses the proposed solution to the problems of digitalization, namely Pillar One. The chapter explains what the proposal entails; the scope, covered activities, the current thresholds, and the implementation process.

The fourth chapter addresses the potential implementation of Pillar One through a directive. The chapter discloses the relevant legal framework for an implementation through a directive as well as gives a historic background to earlier attempts of the EU to establish similar rules in the internal market. Due to the limited competence of the EU in the field of direct taxation, the relevant legal framework consists of art. 115 and 18 TFEU, art. 5 TEU, and the fundamental freedoms. For a better understanding of these provisions and how they are used, relevant case law from the CJEU is examined as well as the overall structure of the CJEU examination of compatibility issues of national provisions. A special account is also made of the relationship between the freedom of establishment and the other fundamental freedoms. Additionally, the chapter accounts for the newly relaunched CCCTB rules, now named BEFIT, and overlooks the reasoning behind the compatibility of the BEFIT rules with union law. This is done to deepen the analysis and give the conclusions more validity.

In the fifth chapter, the analysis is presented, which is based on the research questions determined in chapter 1.2 and the materials accounted for in the following chapters. The discussion begins with the possibility of implementing Pillar One into the union in the form of a directive. A directive is considered in regards to the EU’s competence in the field of direct taxation and the principles of subsidiarity and proportionality. The analysis is based on the previous attempts of the EU to introduce similar rules, namely the CCCTB. Furthermore, the second part of the analysis focuses on the compatibility issues of Pillar One versus the freedoms of the TFEU. Due to the case-law of the CJEU which is accounted for in chapter four, the discussion revolves around the freedom of establishment. The discussion is based on the legal framework presented in the previous chapter and substantiated by relevant judgments of the CJEU. Lastly, chapter six presents concluding remarks on the findings of the thesis.

2 The Challenges of Taxing the Digital Economy

2.1 Introduction

The goal of this chapter is to provide an overview of the development of the international tax regime and the challenges that it now faces due to the digitalization. Essential principles of state taxation are presented which are relevant to the forthcoming analysis and the understanding of the proposal of Pillar One. This chapter sheds light on the issues the international corporate tax rules are facing by the digitalization.

2.2 Challenges of the Competing Demands of Source and Residence Taxation

Traditionally, several widely accepted principles have guided the development of the international tax regime. These overarching principles consist of neutrality, equity, effectiveness, fairness, etc., and are not only applicable in relation to conventional commerce but also in relation to electronic commerce as stated by the OECD in the Ottawa report.[18] Source and resident-based taxation are the two main principles of international tax law. [19] The majority of countries use both principles as a basis for their right to tax both consumption and income.[20]

[18] OECD, *Electronic Commerce: Taxation Framework Conditions*, 1998, p.4-5.

[19] In this thesis this definition of source taxation will be used. Source taxation is based on the connection between the territory and the income derived from it by the taxpayer. Source taxation applies to inbound investments and is imposed on income sourced in their jurisdiction. Generally, active business income is taxed on a net income basis at the marginal tax rate of the non-resident taxpayer while other forms of passive income are taxed on a gross basis. See e.g., Elliffe, *Taxing the Digital Economy: Theory, Policy and Practice*, Cambridge, Cambridge University Press, 2021.

[20] Dahlberg, 2020, p. 33.

Theoretically, countries could operate exclusively on source or residence-based taxation. [21] The problem with residence-based taxation is that for it to work effectively all countries must tax their residents. If there were an agreement that all states would tax their residents but not non-residents on income sourced in their jurisdiction it would potentially work.[22] Although, this could also create problems in respect of states competing on tax rates. The lower the tax rate the more taxpayers would want to become residents of that state, which would consequently lead to other states to either lose tax income or lower their tax rates. On the other hand, historically many countries operated based on source-taxation because it did not require the same degree of international cooperation as residence-based taxation. Due to the globalization of the economy, it is difficult to retain this type of territorial-based taxation as residents would be able to divert all of their capital overseas and escape local taxation.[23]

After the First World War trade became increasingly international which prompted states to move from a territorial tax system into a more worldwide residence-based system while simultaneously increasing the tax rates. The reason behind this move was the enormous expenditure amassed by many states involved in the war. The combination of high tax rates and juridical double taxation led in 1920, the International Chamber of Commerce to initiate a request to the League of Nations to address the problem. The outcome of this request was a report in 1923 for the future framework of international taxation. The report is seen by some as the foundation of the original tax agreements on the elimination of international double taxation.[24]

[21] Resident-based taxation focuses on the relationship between the taxpayer and the state in question. When residence-based taxation is employed, the question of where the taxpayer's residence is located is the critical question for most jurisdictions. There are no cohesive criteria to determine a taxpayer's residence but the most important aspect is that the taxpayer has a real link to the state in question, such as nationality or domicile. Residence-based taxation applies to outbound investment when it comes to cross-border business income. See e.g., Elliffe, 2021 and Dahlberg, *Internationell Beskattning*, 5th edition, Lund, 2020.

[22] Elliffe, 2021, p. 7–8.

[23] Elliffe, 2021, p. 8–9.

[24] See e.g., Reuven Avi Yonah, *Advanced Introduction to International Tax Law*, 2nd edition, Cheltenham, Edward Elgar, [2019], also Hugh Ault, *Corporate Integration, Tax*

The report set out a framework for the allocation of taxing rights for the international tax system by an arbitrary compromise which since then has been accepted by large parts of the international community.[25]

Since countries have sovereignty over the design of their tax system and usually apply both residence and- source-based taxation, this leads to a collision between the demands of two or more countries over the same taxpayer or the income of that taxpayer.[26] If two or more states impose comparable taxes on the same taxpayer in respect of the same subject matter and for identical periods, it is defined as international double taxation by the OECD.[27] International double taxation creates obstacles to the development of economic relations between countries and oppresses international trade. As these effects are seemed as harmful many countries have eliminated them by bilateral agreements long before the OECD[28] came out with the Model Convention on Income and on Capital[29] in 1955.[30]

The OEEC and later on its successor the OECD continued the work of developing a system for the avoidance of double taxation. The Model Convention, first introduced in 1963, included a PE concept in art. 5. Between 1963 and 2000 minor changes were made which only strengthened residence taxation and consequently narrowed down the scope of taxation in the source state. As the global circumstances changed the pressure to update art. 5 has increased and reversed the trend of narrowing down the nexus for source taxation. Further changes to the PE concept were made as a result of the work of OECD and G20 with the *Base Erosion and Profit Shifting*[31] project. The BEPS Action Plan was presented in 2015 and contained several

Treaties and the Division of the International Tax Base: Principles and Practise in Tax Law Review 565, vol. 47 1992.

[25] Elliffe, 2021, p. 10–17.

[26] Dahlberg, 2020, p. 35.

[27] OECD, *Model Tax Convention on Income and on Capital: Condensed Version 2017*, Paris, OECD, 2017, p. 9. Hereinafter “OECD, Model Convention, 2017”.

[28] At that time, it was called OEEC (Organisation for European Economic Co-operation).

[29] Cited” Model Convention”.

[30] OECD, Model Convention, 2017, p. 9–10.

[31] Cited” BEPS”.

changes relevant to the taxation of PEs, most notably Action 7 aiming at preventing avoidance of the PE status to avoid a taxable nexus in the source state. In conjunction with the BEPS project art. 5 was revised to widen the PE threshold to strengthen source taxation.[32]

The general definition of a PE is established in art. 5.1 and is a result of a balancing act between residence and source taxation as the main principle is that business profits are only taxable in the residence state unless the enterprise has a PE in the source state. Art. 5.1 defines the sufficient level of activity required for an enterprise to create taxable nexus in the source state. A PE is considered to exist if there is a fixed place of business through which the business of an enterprise is wholly or partly carried on. Thus, the article sets out three conditions, a fixed place, the place must be of a permanent feature and the business must be conducted from this place.[33] The second condition is that the place of the business must be of a certain degree of permanence.[34] The third and last condition in art. 5.1 states that the business must be conducted in whole or part from the permanent place.[35] Consequently, the activity does not have to be of a productive nature but it is required that the activity is carried out on a regular basis.

[32] OECD, *Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project*, OECD Publishing, Paris, 2015.

[33] See OECD, Model Convention, 2017, art. 5. The first criterion requires an enterprise to have a fixed place e.g., premises or facilities used to conduct the business. Under certain conditions a device such as a machine or a server may constitute a place of business. Furthermore, the enterprise must also have full disposal of the site which is determined on the actual possibilities the enterprise has of using the site.

[34] See OECD, Model Convention Commentary, 2017, Art. 5 para. 28. The required time limit is not entirely clear among the member states of OECD but as a starting point it has been considered that a place cannot be permanent if the business has been conducted for less than six months. However, businesses of a recurring nature have been exempted for this six-month rule.

[35] See, OECD, Model Convention Commentary, 2017, Art. 5 para. 35.

2.3 Digitalization and IPS-servers - Challenging the Current Taxation System

As the global economy has digitalized new questions have arisen regarding the concept of PE and its relationship to electronic commerce. The discussions have revolved around the possibility of e-commerce and server and website providers to constitute a PE.[36] The commentary to art. 5 makes an important distinction between automated computer equipment and the data and software which may be used or stored on, that equipment. While computer equipment (hardware) can under certain situations be regarded as a PE, the mere existence and use of a website does not in itself constitute tangible property and can therefore not establish a PE because it does not have a physical location, which is one of the requirements in art. 5.1. Although, the website does not constitute a PE the server on which the website is stored on may constitute a fixed place of business and thus be regarded as a PE in the country where the server is situated for the enterprise that operates the server.[37]

Another important distinction should be made between the server and the website that is stored on it. Generally, two different enterprises are concerned when dealing with this issue, the enterprise that owns the server and the enterprise that owns the website. An Internet Service Provider (ISP) is a company that owns a server and provides internet services to several other enterprises. Usually, the agreements between the ISP providers and enterprises do not result in the server and its location being at the enterprise's disposal even if the enterprise had the possibility to choose a particular server and location. In these situations, the enterprise cannot be considered to have a physical presence at the location and consequently, the website does not constitute a PE. On the other hand, if the enterprise which owns and carries on business from a website has the server at its disposal

[36] Dahlberg, 2020, p. 302–303.
[37] OECD, Model Convention Commentary, 2017, Art. 5 para. 123.

through owning or leasing the server and the enterprise operates the server, the place of the server could constitute a PE as long as the other requirements are met.[38]

Thus, digitalization has raised several questions, most notably if the requirement of a physical presence is viable in a digitalized economy where the concept of conducting business has changed quite drastically from the bricks-and-mortar economy the international taxation rules were built upon.[39]

2.4 A solution in the making

As a result of the challenges posed by the digitalization of the economy, such as new forms to conduct business, new business models, and mismatches of legal systems, decision-makers have been required to ensure that the international tax regime keeps pace with the developments. The change has led to policymakers struggling to cope with the complex issues presented in front of them, as they need to adapt to a new environment while remaining principled, consistent, and clear in the development and implementation of their regulation. To counteract the exploitation of weaknesses in existing tax rules, for example, hybrid mismatch arrangements, the OECD launched the BEPS project.[40] The BEPS project identified numerous tax issues raised by the digitalization and developed solutions to address these issues in the forthcoming reports. The BEPS project focused mostly on the issue of base erosion and profit shifting and had a goal of renovating the international tax system and tackling double non-taxation. In 2013, the OECD and member states in the G20 adopted an action plan with 15 actions to address the challenges identified by the BEPS project. The different action plans are raging from issues regarding the effects of hybrid mismatch arrangements to treaty abuse and the alignment

[38] OECD, Model Convention Commentary, 2017, Art. 5 para. 123-124.
[39] Hentschel, *Taxation of Permanent Establishments*, Halle, Springer Gabler, 2020, p. 41–42.
[40] Haslehner, Kofler, Pantazatou, & Rust (red.), *Tax and digital economy: challenges and proposals for reform*, Alphen aan den Rijn, Wolters Law International, 2019, p. 1–2.

of transfer pricing outcomes with value creation. The OECD/G20 presented in 2015 the Action 1 Report which recognized that new challenges arose in the field of international taxation, in respect of direct taxation like corporate taxation but also indirect taxation concerning the collection of VAT/GST on goods and services purchased online.[41]

Furthermore, the Action 1 Report determined a number of challenges connected to the digitalization of the economy related to the rules of nexus, data, and characterization. The report stated that these challenges went beyond the target of the BEPS Project but were chiefly related to the allocation of taxing rights on the income of cross-border activity. The OECD presented a few options to address the issues including a new nexus based on significant economic presence, the use of withholding tax, and a digital equalization levy but did not expressly recommend an option for implementation.[42] The work has continued at the OECD, IF[43] and G20 level, and in 2018 they presented an interim report[44] which included an array of updates and discussed more in-depth the possible development of a durable, long-term solution to the tax challenges identified.[45]

The interim report was followed by an update in 2019 and in October 2020 the OECD/IF published two Blueprints regarding a unified approach to the tax challenges posed by the digitalized economy. The proposal is divided into two sections, Pillar One and Pillar Two. Pillar One intends to update the international income tax system to the digital age through the amendment of profit allocation and nexus rules applicable to business profits. Pillar One aims to expand the taxing rights of market jurisdictions based on active and

[41] OECD, Action 1, 2015, chapter 7 note 1.
[42] OECD, Action 1, 2015, chapter 7 note 1.
[43] The BEPS Project was initiated by the OECD and G20 which later requested that the OECD develop a more inclusive framework with involvement of non-G20 members most notably developing countries.
[44] See, OECD, *Tax Challenges Arising from Digitalisation – Interim Report 2018*: *Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, Paris, OECD Publishing, 2018.
[45] Haslehner, Kofler, Pantazatou, & Rust, 2019, p. 3–8.

sustained participation of a business.[46] The aim of Pillar two is to implement a global equalization levy on MNEs.[47] Recently OECD published a statement that the international community, most members of the OECD/G20 Inclusive Framework on BEPS, had agreed on a global minimum corporate tax rate set at 15 per cent. The agreement is of great value as it sets out the playing field for both corporations but also the continuing work of Pillar Two. The OECD aims to present a multilateral convention by 2022 with effective implementation in 2023.[48]

[46] See OECD, *Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, Paris, OECD Publishing, 2020. Hereinafter "OECD, Blueprint – Pillar One".

[47] See OECD, *Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, Paris, OECD Publishing, 2020.

[48] OECD, *International community strikes a ground-breaking tax deal for the digital age,* 2021.

3 OECD’s Solution to the Problems of Digitalization

3.1 Introduction

This chapter provides an examination of the OECD proposal of Pillar One. The chapter explores and describes the new rules of a digital permanent establishment which are encompassed in the first part of Pillar One, Amount A. This examination lays the ground for the coming analysis, where the rules of Amount A will be examined against particular provisions of union law.

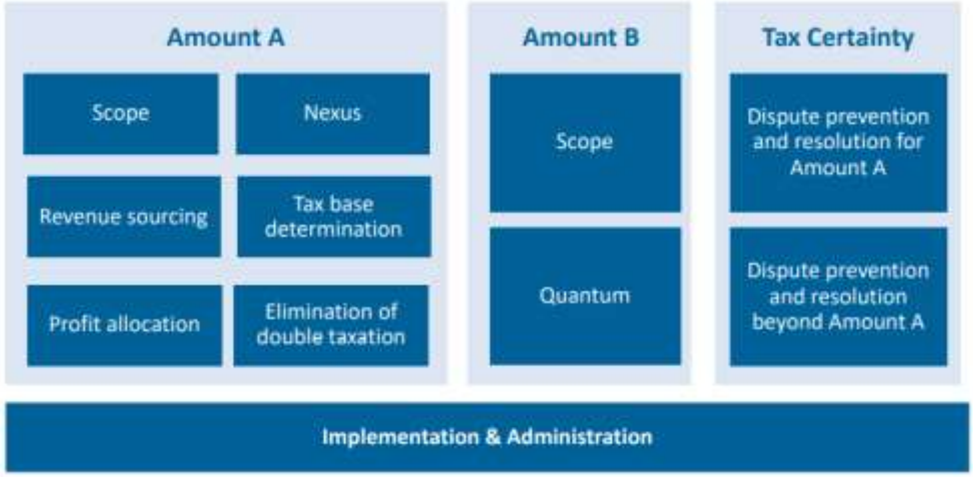
3.2 Pillar One

3.2.1 Introduction

The aim of Pillar One is as stated above, to introduce a new nexus and profit allocation rules. The new nexus rules are supposed to better fit into the digital age and the new business models that have emerged, which no longer are within the scope of the existing international tax rules. The new nexus rules would expand the taxing rights of market jurisdictions, i.e., states where users and consumers are located, where there is an active and sufficiently high economic and digital presence of a business. The major difference from the exiting nexus rules is that the new nexus does not require a physical presence for a taxable nexus to exist in a market jurisdiction. The Blueprint for Pillar One is divided into three parts, Amount A, Amount B, and Tax Certainty. Within these three components, there are eleven building blocks that are essential to the construction of Pillar One as a whole package.[49]

[49] OECD, Blueprint – Pillar One, 2020, p. 10–11.

Figure 1.1. Building Blocks of Pillar One


Amount A
Scope
Nexus
Revenue sourcing
Tax base determination
Profit allocation
Elimination of double taxation
Amount B
Scope
Quantum
Tax Certainty
Dispute prevention and resolution for Amount A
Dispute prevention and resolution beyond Amount A
Implementation & Administration

[50]

Since 2019 when the Blueprint on Pillar One first was published there have been some changes to the proposal. In the beginning, the main focus group of Pillar One was Automated Digital Services (ADS) but as some countries advocated for the use of a wider scope of activities to be included, consumer Facing Businesses (CFB) were included.[51]

3.2.2 Pillar One – October 2020

In the Blueprint of 2020, the scope was determined based on two tests, an activity test, and a threshold test. The activity test included two groups of businesses in the definition of the in-scope activities which were the ADS and CFB. These two groups of digital businesses mirror the type of activities where the policy challenge is most acute. The OECD did a great deal of work in defining ADS and CFB but there was no political agreement on the use of the categories. The main target of the activity test was to determine which MNEs fall within the scope of the ADS or CFB businesses that are defined in Pillar One as to be able to participate in a sustained and significant manner in the economic life of a market jurisdiction.[52]

[50] OECD, Blueprint – Pillar One, 2020, p. 11.
[51] OECD, Blueprint – Pillar One, 2020, p. 11–12.
[52] OECD, Blueprint – Pillar One, 2020, p. 19.

The definition of ADS is comprised of a general definition, a positive list of ADS activities, and a list of non-ADS activities. The general definition was built on two elements, that the service was automated and digital. In other words, the service had to be made available by an MNE to users through digital means which could be achieved by equipment and systems in place and were automated, requiring minimal human involvement. This general definition aimed to ensure that the new rules applied to rapid change and the possibility of new business models emerging that might not fit into the positive or negative list of an ADS. When determining if an activity is regarded as constituting an ADS the first thing will be to identify if the activity is included in the positive list which includes, online advertising, sale or other alienation of user data, social media platforms, etc. secondly if the activity is not on the positive list, the following thing to do is to see if the activity is included on the negative list, which includes activities as customized online teaching services, customized professional services and more. If the activity is on the negative list, it is deemed not to be an ADS and only if the activity is on neither list the general definition is used to determine if the activity is of ADS nature.[53]

The inclusion of a broader group of CFB in the scope of Amount A reflected the digital age in the sense that not only businesses that provide ADS could participate in an active and sustained manner in the economic life of a market jurisdiction. The CFB included a more traditional group of businesses that had not been disrupted by the digitalization but had embraced it and learned to engage with consumers in a meaningful way without the need of a physical presence.[54] The definition of a CFB in Pillar One was a business that could generate revenue from sales of goods and services that was of a type commonly sold to consumers, including businesses selling directly or through intermediaries and by way of franchising or licensing.[55] The digitalization enabled MNEs to create

[53] OECD, Blueprint – Pillar One, 2020, p. 19–20.
[54] OECD, Blueprint – Pillar One, 2020, p. 20–21.
[55] OECD, Blueprint – Pillar One, 2020, p. 37.

significant and sustained relationships with their consumers which improved the value of the brand and their products. Furthermore, the collection and exploitation of individual consumer data are intangible assets that allow MNEs to earn residual profits from remote markets without a corresponding share assigned to that market jurisdiction.[56]

The Blueprint report for Pillar One also identified different types of activities that were proposed to be excluded from Amount A.[57] Among these were financial services, certain natural resources, construction, sale, and leasing of residential property, and lastly, international airline and shipping businesses. The reason behind the exclusion of certain sectors was that these would naturally fall out of the scope of Amount A because they are neither consumer products nor ADS, but for clarity reasons, the specific exclusions were set out for the whole or parts of these sectors. The exclusions were meant to be applied on a segment basis which would render that an MNE group with multiple business lines might find themselves in the situation that some parts of the group might fall within the scope of the exclusions and some might not.[58]

The second element of defining the scope of Amount A was the threshold test. The OECD recognized that implementation of Amount A would likely lead to additional compliance and administrative costs which could not be justified by a cost-benefit analysis. The OECD determined that large businesses would handle the implementation of the new rules better as they usually possess the financial and human resources in addition to the systems in their tax function to manage the process of implementing and complying with new rules. Smaller MNEs would struggle with the additional compliance costs, not to mention that the amount of residual profit available to be allocated to other market jurisdictions would be insignificant in contrast to the compliance costs for the MNE.[59]

[56] OECD, Blueprint – Pillar One, 2020, p. 20–21.
[57] OECD, Blueprint – Pillar One, 2020, p. 22.
[58] OECD, Blueprint – Pillar One, 2020, p. 47–56.
[59] OECD, Blueprint – Pillar One, 2020, p. 58.

In the Blueprint of 2020, the in-scope MNEs were determined by a threshold test, which consisted of two thresholds. The first threshold consisted of a global revenue test. The first test considered a threshold based on global revenue which set the bar at EUR 750 million, the same threshold as is used for the purpose of Country-by-Country reporting (CbCR).[60] A second test called the de minimis foreign in-scope revenue test, which excludes certain MNEs which exceed the threshold set in the activity test but consist mainly of domestic enterprises. The OECD stated that the exclusion of these types of MNEs was justified by the disproportionate effects the new rules would have on the MNEs with regard to the cost and workload.[61]

The nexus rules which determined which states were regarded as market jurisdictions and therefore eligible to receive a proportion of Amount A, were based on several indicators of significant and sustained engagement of an MNE in a particular state.[62] If it was determined that an MNE did not have an engagement that met the requirements, none of the MNEs profits would be reallocated to the state in question. The nexus rules were considered to apply differently to ADS and CFB businesses, as a revenue threshold was seen as sufficient for an ADS to establish a nexus in contrast to the CFB where a higher standard to establish nexus was considered.[63]

The Blueprint of 2020, contained a detailed draft of the revenue sourcing rules which would have determined the origin of the revenue which would have facilitated the application of the scope and nexus rules. The proposal identified a sourcing principle for each type of in-scope revenue as well as a hierarchical list which the MNEs would use to apply the principle and determine the source jurisdiction.[64] The sourcing rules were categorized

[60] OECD, Blueprint – Pillar One, 2020, p. 58-59.
[61] OECD, Blueprint – Pillar One, 2020, p. 59–60.
[62] OECD, Blueprint – Pillar One, 2020, p. 64.
[63] OECD, Blueprint – Pillar One, 2020, p. 64-65.
[64] OECD, Blueprint – Pillar One, 2020, p. 70.

under the different business groups and further divided under several in-scope activities which all had a sourcing principle and a hierarchical place.[65]

3.2.3 Pillar One – October 2021

In their statement of October 2021, the OECD presented the two Pillar proposals with new components that the international community had agreed on. The 2021 proposal differs from the previous draft proposals on a few aspects, most notably the scope of Amount A.

According to the OECD, the new scope is determined by the MNE's global turnover and profitability percentage before tax. An MNE will be liable for taxation according to Amount A if the MNE has a global turnover above 20 billion euros and a profitability rate above 10 percent before tax. The turnover and profitability rate are calculated by the use of an averaging mechanism. The global turnover threshold would be lowered to 10 billion euros but it is contingent on the successful implementation of Pillar One. Considering that the review of Pillar One would only be conducted seven years after its entry into force and the reduced turnover threshold requires a successful implementation, it can be questioned if the reduction is feasible.[66]

Comparing the two proposals from 2020 and 2021, it is evident that a drastic change has been made to the scope of Amount A. The new threshold for global turnover which has been raised from 750 million euros to 20 billion euros entails that around 369 enterprises of the 500 largest enterprises in the world would exceed the threshold. Although these MNEs exceed the turnover threshold, the new addition of a profitability rate reduces the in-scope MNEs to around 100 as the majority of the MNEs do not have a profitability rate above 10 percent. However, the aggregated profit amount from Pillar One would still be very similar to the 2020

[65] OECD, Blueprint – Pillar One, 2020, p. 70-71.

[66] OECD, *Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy*, OECD/G20 Base Erosion and Profit Shifting Project, 2021, p. 1. Hereinafter "OECD, Statement, 2021".

proposal if it would have been implemented as set out in the draft.[67] The 2021 proposal will as the previous exclude the financial service and extractive sectors but it is implied that the raised turnover threshold is due to the elimination of the activity test which concerned ADS and CFB businesses.[68]

The nexus rules have also been altered compared to the 2020 draft. A state will be entitled to an allocation of Amount A when the in-scope MNE generates at least one million euros in revenue in that particular state. Countries with a GDP[69] lower than 40 billion euros will have a lower threshold of 250 000 euros. States that meet the requirements are considered as market jurisdictions and would be able to tax 25 percent of the MNE's residual profit defined as profit above 10 percent of revenue.[70]

The nexus rules are supported by the revenue sourcing rules which have the aim of determining the revenue that would be treated as derived from a certain state. The revenue will be attributed to the end market jurisdiction where the goods or services are used or consumed. The OECD stated that the application of the sourcing rules which have not been developed at the time, will be determined for each specific group of transactions and the MNEs will be obligated to use a reliable method when applying the sourcing rules.[71]

The implementation of Amount A will according to the OECD be conducted through a multilateral convention that will be developed and opened for signature in 2022 and expected to enter into force in 2023. However, all parties to the multilateral convention will be required to remove or to refrain

[67] Devereux & Simmler, *Who Will Pay Amount A?* in EconPol Policy Brief, No. 36, Munich, IFO Institute - Leibniz Institute for Economic Research at the University of Munich, 2021, p. 3-4.
[68] OECD, Statement, 2021.
[69] Gross Domestic Product – the total monetary or market value of all the goods and services produced within a state.
[70] OECD, Statement, 2021, p. 2.
[71] OECD, Statement, 2021, p. 2.

from introducing digital service taxes and other similar measures.[72] It has been determined that the digital service taxes that some states have introduced e.g., France, Austria, the United Kingdom, and Poland[73] will not be imposed on MNEs as of October 8th, 2021 until the 31st of December 2023 or until the multilateral convention coming into force.[74]

[72] OECD, Statement, 2021, p. 2.
[73] Tax Foundation, *What European OECD Countries Are Doing About Digital Service Taxes*, 2021. https://taxfoundation.org/digital-tax-europe-2020/ (Retrieved 23.11.2021.).
[74] OECD, Statement, 2021, p. 3.

4 Introduction of Pillar One in the European Union – A Preliminary Assessment

4.1 Introduction

This chapter aims to present the European Union, its goals, functioning, and future aims. This chapter acts as a support chapter where the context of the relevant legal rules is displayed in order to be followed up in the analysis. Hence, the chapter begins with a general account of the functioning of the internal market, to give context to the reader about the history of the Union and why some rules and principles have emerged. This is followed by a brief presentation of the EU institution's competence in the field of direct taxation. In order to partially answer the thesis' second question, a more detailed presentation of the EU's aim of introducing a common corporate tax system is made.

4.2 The legal framework

4.2.1 Internal Market and the Fundamental Freedoms

The fundamental aims of the European Union (EU) have in essence, remained the same since the Union was founded until now.[75] The Union's ambitions are to promote peace, common values, and the well-being of the people. To be able to achieve and maintain these goals the EU established an internal market with the purpose to eliminate social and economic discrimination and promote economic, social, and territorial cohesion among the member states.[76] While the goals of the EU and its internal market have been the same over the years, the view of the means, i.e., the

[75] Everling, *The European Union as a Federal Association of States and Citizens,* Oxford: Hart, 2009, p. 704-705.
[76] European Union, *Treaty on European Union. Consolidated version of the Treaty on European Union,* (TEU), Brussel, 2012, art. 3.

internal market, has changed over time. The internal market was at its introduction used as a cooperative tool to promote peace within Europe and economic growth. Later on, the peace aspect fell into the background as the fundamental freedoms were introduced and the internal market granted its citizens rights to strengthen the social aspects of European integration. The internal market has strengthened the EU's position as an international actor with the possibility to affect other major powers like the US, Russia, or China, and impact their decisions.[77] The specific objectives of the internal market are to enable the free movement of goods[78], persons[79], services[80], and capital[81] within the territory of the union.[82] These objectives are often referred to as the four freedoms on which the internal market is built upon.[83] The freedom of movement is generally considered to include the free movement of both natural and legal bodies which encompasses the freedom of establishment.[84] These freedoms are only applicable to cross-border situations within the Union.[85] Only the freedom of capital movement can be applicable in situations concerning the movement of capital between member states and third countries.[86]

To maintain the internal market and the freedoms that it grants, the Court of Justice of the European Union has in a number of cases failed national tax rules that restricted or made it more difficult for individuals to operate within the Union. These cases have mostly concerned the situation that a member state has treated cross-border situations in a less favourable way

[77] See e.g., the preamble of TFEU, TEU; the Communication from the commission – A fair and Efficient Corporate Tax System in the European Union and Craig & de Búrca (red.), *The Evolution of EU Law*, [2021], 3rd edition.

[78] European Commission, *Consolidated version of the Treaty on the Functioning of the European Union*, Lisbon, 2007, art. 28 TFEU.

[79] See art. 45 TFEU, which prohibits restrictions on the free movement of workers and art. 49 TFEU concerning the freedom of establishment for both natural and legal persons.

[80] See art. 56 TFEU concerning the prohibition of restrictions on services, which is further defined in art. 57 TFEU.

[81] See art. 63 TFEU.

[82] See art. 26 TFEU.

[83] Goldsmith Q.C., *A charter of rights, freedoms and principles*, Netherlands, 2001, p. 1209.

[84] Goldsmith Q.C, 2001, p. 1213 and Dahlberg, *Internationell Beskattning*, 5th edition, Lund, 2020, p. 372.

[85] C-107/94, Asscher, para. 32.

[86] Art. 63 TFEU.

than corresponding domestic situations, by either inhibiting foreign establishments or made it more difficult for domestic corporations to move or operate in another member state.[87] Apart from the fundamental freedoms of the EU, there are also other provisions that protect and maintain the internal market. The EU has also established a customs union which eliminates all customs between member states.[88] Furthermore, the EU has a shared competition policy that prohibits enterprises to restrict fair and just competition within the union by engaging in competition restricting deals or by the misuse of their dominating position.[89] The rules on state aid are also meant to restrict the possibility for member states to protect domestic businesses from competition by favouring certain enterprises or business branches. The member states are not allowed to give out aid or other governmental funds to domestic enterprises if it can distort or threaten to distort the competition.[90]

According to art. 110 TFEU the member states are prohibited to impose any domestic tax rules of a solely protective nature. Member states can neither directly nor indirectly impose domestic taxes or levies on goods and services from other member states which are higher than the taxes or charges directly or indirectly imposed on similar domestic products. The provision is still applicable regardless of the kind of goods and their similarity as long as they are in a competitive relationship with some of them even if only partially, indirectly, or potentially. [91] These rules aim to secure that the domestic taxation rules and levies are completely neutral regarding the competition between domestic and imported goods.[92]

[87] See Royal Bank of Scotland (C-311/97); Mark & Spencer (C-446/03) and Verkooijen (C-35/98).
[88] See art. 30-32 TFEU.
[89] See art. 101-102 TFEU.
[90] See art. 107-109 TFEU.
[91] See the Commission v. Belgium (C-356/85) para. 7.
[92] See art. 110 TFEU.

4.2.2 Freedom of Establishment

The internal market is, as earlier mentioned, characterized by the fundamental freedoms which are regulated in several articles in TFEU. Of most importance for the thesis is the freedom of establishment which will be further analyzed in the following section.

The freedom of establishment is divided over six articles, from art. 49 to art. 54 TFEU of which art. 49 is the main article providing the right. The article stipulates, that restrictions on the right of EU citizens to freely establish themselves in the territory of another member state are prohibited. The right to establishment encompasses both primary and secondary establishments, such as agencies, branches, or subsidiaries. The second paragraph of art. 49 TFEU further explains what is meant by the freedom of establishment. Freedom of establishment includes the right to found and conduct business as a self-employed person and also to form and manage undertakings, especially enterprises within the meaning of public or private law of that particular member state.[93] Hence, the freedom of establishment can be invoked by both natural and legal bodies.

As mentioned earlier, the fundamental freedoms, including the freedom of establishment, has to concern a cross-border situation for the articles to be applicable. Art. 49 TFEU prohibits both direct and indirect discrimination on the basis of nationality.[94] Therefore, tax treaties or national tax rules may conflict with TFEU if two citizens of different member states are treated differently in a comparable situation or if two citizens of different member states are treated alike in a different situation, resulting in that one of them are treated worse than the other.[95] According to CJEU case law, the freedom of establishment not only prohibits discrimination based on nationality but also restrictions of non-discriminative nature that nonetheless restrict the EU

[93] See Art. 49 and 54 TFEU.
[94] Helminen, *EU Tax Law: Direct Taxation*, 2018 edition, Amsterdam: IBFD, p. 92-94.
[95] See e.g., Futura (C-250/95), Asscher (C-107/94) and Saint-Gobain (C-307/97).

citizen's right.[96] Additionally, it is sufficient that a tax provision or practice may create a restriction on the freedom of establishment to be considered incompatible with the article of the Treaty. Hence, it is not required to establish that the domestic provision or practice actually has had a negative effect on enterprises and refrained them from establishing, acquiring, or maintaining a subsidiary in another member state.[97]

In relation to enterprises, their registered office serves as the enterprise's nationality, connecting the enterprise to the legal system of that particular state. If an enterprise establishes itself within the Union but not in accordance with the law of a member state, the enterprise cannot invoke the protection that the freedom of establishment guarantees.[98] The freedom of establishment also works vice versa meaning that non-EU members can benefit from the protection of art. 49 TFEU by establishing a subsidiary or branch in accordance with the laws of an EU member state, but the protection is not granted to establishments outside of the Union.[99]

Initially, the CJEU mainly examined domestic tax provisions and practices in the host state.[100] Most commonly the cases concerned the situations where the host state prescribed different conditions for enterprises established in another member state. The CJEU determined that the difference in treatment constituted restrictions on the freedom of establishment and therefore were in breach with art. 49 TFEU.[101] The aim of art. 49 TFEU is to ensure a national treatment in both the host and the origin state, as well as to prohibit the state of origin from preventing its nationals, both legal and natural bodies, from establishing themselves in another member state.[102]

[96] See e.g., Daily Mail (C-81/87); Safir (C-118/96 and Gebhard (C-55/94).
[97] Oy AA (C-231/05) para. 42 and Test Claimants in the Thin Cap Group Litigation (C-524/04) para. 62.
[98] See e.g., Kronos (C-47/12) para. 46.
[99] Helminen, 2018, p. 96.
[100] See e.g., Avoir Fiscal (C-270/83); Joined cases Metallgesellschaft and Others (C-397/98 and C-410/98).
[101] See e.g., CLT-UFA SA (C-253/03) para. 31 and Avoir Fiscal (C-270/83) paras. 27-28.
[102] Marks & Spencer (C- 446/03) para. 31 and ICI (C- 264/96) para 21.

According to art. 54. TFEU, the provision extends the protection of freedom of establishment to enterprises established in accordance with domestic law, which equates them with natural and legal persons who are nationals of the member state.[103] Freedom of establishment is an important part of the EU's work to create and maintain the internal market and the internationalization of it. It is an important component for the possibility to provide various types of goods and services across national borders.[104] For a long time, member states believed that the fundamental freedoms could not have an impact on the field of tax law. However, in the case of *Avoir Fiscal*[105], the CJEU stated that tax provisions that impede the freedom of establishment may be challenged under the provisions of the TFEU. The freedom of establishment has a direct effect, which means that a national provision that is considered to be in conflict with the freedom must be set aside if the provision cannot be justified and if there are no other measures that would be less intrusive.[106]

The general principles expressed in the *Avoir Fiscal* case have continued to be relevant in the CJEUs application of the law. The first principle expressed in the case was the "principle of recognition" which is used to establish comparability in domestic situations. The principle is still widely applied, especially to determine a taxable person. Furthermore, the court rejected the member states' grounds for justification based on reciprocity, which have remained unchanged at least in cases of vertical discrimination. Finally, the principle of territoriality which was applied in the case to establish comparability between a citizen and a permanent establishment seems to remain as a constant in the case-law of the CJEU.[107] In case C-205/84, the CJEU identified several requirements that had to be fulfilled for

[103] Art. 54 TFEU.
[104] Bernitz & Kjellgren, *Europarättens grunder*, 6th edition, Nordstedts Juridik, 2018, p. 272.
[105] C- 270/83, Commission v France, Avoir Fiscal, 1986.
[106] See e.g., RÅ 2008 ref. 30.
[107] Haslehner, Kofler & Rust (red.), *EU tax law and policy in the 21st century,* Alphen aan den Rijn: Wolters Kluwer, [2017], p.391.

a permanent establishment to be covered by the freedom of establishment. The most important requirement was the requirement of a physical presence in the member state. Thus, an enterprise must have a physical presence in a member state to enjoy the protection given by the freedom of establishment.[108]

In most cases before the CJEU, the questions concern more than one of the fundamental freedoms. Art. 65.2 TFEU considers the relation between the freedom of establishment and the freedom of capital and payments. The case law of the CJEU established that concerning other fundamental freedoms the freedom of establishment has priority, thus making it unnecessary to investigate if there exist any obstacles to the other freedoms.[109] In another case concerning the competing rights of freedom of establishment and freedom of capital movement, the CJEU stated that the second paragraph of art. 52 TFEU stipulates that the freedom of establishment includes the right of an EU citizen to set up and operate a business of another member state. Therefore, an EU citizen who holds the capital of an enterprise established in another member state and who thereby has a significant influence over the enterprise's decisions and activities thus exercises his right of establishment.[110]

4.2.3 Positive Integration in the Field of Direct Taxation

The Union law acts are divided into primary and secondary sources of law. The primary law acts consist of the treaties (TEU, TFEU) with associated protocols, annexes, general principles of the Union, and also the Charter of Rights. Other legal acts as directives, regulations, and decisions are considered to be of secondary nature.[111] Five measures are qualifying as legal acts within the Union; regulations, directives, decisions,

[108] C- 205/84 Commission vs Germany, Para 2.
[109] See e.g., Hervis Sport (C-385/12) paras. 20-24 and X and Y (C-436/00) para. 66-74.
[110] Baars (C-251/98) para 22.
[111] Chalmers, Davies & Monti, *European Union law: cases and materials*, 2nd edition, Cambridge, Cambridge University Press, 2010, p. 98-100.

recommendations, and opinions.[112] The first three are diversified measures considered as hard law while the other qualifies as soft law.[113] The primary legal acts govern certain fundamental, constitutional, and functional issues concerning the internal market while the secondary acts allow for closer cooperation and harmonization of the laws of the member states. Positive integration requires a legislative procedure to be conducted within the Union as new and common rules would be implemented through a directive or regulation. Negative integration on the other hand occurs through court decisions when domestic rules are deemed to be in conflict with Union law and therefore invalidated.[114]

The legislative measures taken by the EU have the aim of further developing the internal market, either its external or internal function. The level of ambition to fully harmonize the external functions of the internal market are high, in regards to certain customs and trade issues concerning the Union's trade with third countries. While the external functions of the internal market have been vastly harmonized, there is a varying degree of harmonization within the internal functions of the internal market.[115] The possibility of positive integration in the internal market is ultimately regulated in the treaties, which determines the ambition the member states and EU have for each area, from full harmonization and exclusive competence for the EU to less harmonization and more possibilities for the member states to legislate domestically.[116]

In the field of direct taxation, the EU has limited competence and direct taxes are not directly governed by the Union rules. The EU Treaty does not contain any explicit provision for the legislative competencies in the area of direct taxation and the EU is limited to the powers conferred on it by the

[112] Art. 288 TFEU.

[113] Chalmers, Davies, & Monti, 2010, p. 101-103.

[114] Helminen, 2018, p. 10.

[115] Brederode & Krever (red.), *Legal Interpretation of Tax Law: The European Union in Legal interpretation of tax law*, 2nd edition, Alphen aan den Rijn: Wolters Kluwer, [2017] p. 136.

[116] Snell, *The internal market and the philosophies of market integration* in *European Union Law*, in European Union Law, Bernard & Peers (red.), 3rd edition, [2020], p. 321.

member states.[117] The principle of conferral determines in which areas the Union has legislative powers, either exclusive or shared with the member states.[118] The principles of subsidiarity and proportionality further limit the legislative competence of the EU as the EU is not allowed to legislate in an area of shared competence if the objectives of the proposed action can be sufficiently achieved by the member states themselves and the proposed action exceeds what is necessary, to achieve the objectives in the Treaties.[119]

The EU possesses an explicit competence to harmonize indirect taxes but not direct taxes.[120] Direct taxes concern levies directly imposed on income or in relation to the value or properties of an object. The distinction between direct and indirect taxes is ultimately determined by the domestic taxation rules of a country[121] but a distinction that has won recognition within the literary world is by the Advocate General C. Stix-Hackls.[122] Direct taxation has the ability to affect the internal market in a negative way by impeding the movement of workers and businesses but as stated previously the EU treaties only leave a limited apace for harmonization through art. 114 and 115 TFEU.[123] While the customs union has been majorly harmonized, the requirement of unanimity to introduce any new and harmonized regulations has impacted the field of direct taxation. This limitation for positive integration has several explanations, the most significant reason is the concept of national sovereignty, to which the right to tax is closely related.[124] Furthermore, harmonization of the field of direct taxation would restrict the national Parliament's possibility to formulate the tax legislation in accordance with the domestic needs of that country. Because direct taxation accommodates for a large part of a member states' total tax

[117] Art. 5 TEU.
[118] See art. 3 and 4 TFEU.
[119] Art. 5 TEU.
[120] Art. 113. TFEU.
[121] See Kingstone, *The Boundaries of Sovereignty: The ECJ's Controversial Role Applying Internal Market Law to Direct Tax Measures,* in The Cambridge Yearbook of European Legal Studies, Barnard (red.), Oxford, 2007, p. 288 et seq.
[122] Banca poplare di Cremona v. Agenzia Entrate Ufficio Cremona, (C-475/03) para. 53-56.
[123] Hinnekens, *Overview of New Paths and Patters in EU Tax Development with Focus on EU Soft Law and External Factors,* EC Tax Review, 2014, p. 249-255.
[124] Kingstone, 2007, p. 287 f.

revenue, the harmonization would entail a corresponding harmonization of the member state's welfare system, from the possibility to free healthcare to the financing of the pension systems.[125]

Even though the possibility to harmonize the direct tax field within the Union is restricted, the EU legislature has adopted a number of direct tax harmonization measures which are based on art. 115 TFEU. Until now the member states have only agreed on four directives in the field of direct taxes; the Parent-Subsidiary Directive on dividends[126], the Merger Directive on company reorganizations[127], the Interest-Royalty Directive[128], and lastly the Anti-Tax Avoidance Directive[129]. The European Commission has since long advocated for a common corporate tax base within the EU but this has proved to be a question that is hard to agree upon. Despite the establishment of the internal market, enterprises conducting business in Europe have to conform to 27 different national tax systems which create unnecessary compliance costs and furthermore leads to the discouragement of cross-border investments. While this has been one of the European Commission's long quests, it has not had the support needed with the member states. The proposal was introduced in 2011 and has since then had several makeovers, the most recent in 2021 when it was presented that the European Commission, would once more try to relaunch the proposal under a different name with the hope that the work within the OECD has shifted the positions of the Member states regarding a common corporate tax.

[125] Kingstone, 2007, p. 290 f.

[126] European Council, *Council Directive 2011/96/EU on the Common System of Taxation Applicable in the case of Parent Companies and Subsidiaries of Different Member States* 2011.

[127] European Council, *Council Directive 2009/133/EC of 19 October 2009 on the Common System of Taxation Applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States and to the transfer of the registered office of an SE or SCE between Member States*, 2009.

[128] European Council, *Council Directive 2003/49/EC on the Common System of Taxation Applicable to interest and royalty payments made between associated companies of different Member States*, 2003.

[129] European Council, *Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC*, 2011.

4.3 The EU's Ambitions of a Harmonization of Corporate Income Taxation

4.3.1 History Behind the Initiatives of a Harmonized Corporate Taxation

The ambition to harmonize the field of direct corporate taxation has been on the table since the 1960s. As the concern for the centralization of the EU emerged most member states opposed the idea of granting the Commission even the slightest right to regulate in the field of direct taxation. At the time, even limited measures concerning specific tax concessions were regarded by the member states as the beginning of the centralization process and almost immediately rejected. [130] The ambition of the EU has always been to alleviate the problems the different member state legislation creates and to achieve an undistorted internal market. In Vienna 1998, the Commission received the mandate for conducting a study on company taxation as at the time, the general discussion in the EU concerning tax competition, the effects, and efforts to curb down harmful tax competition.[131]

In the 1960s the Neumark Committee[132] presented detailed suggestions for the harmonization of the corporate tax systems in the union in the form of an imputation system and in 1970 the Tempel report[133] suggested an addition of a classical dividend taxation system to the union regime. A few years later in 1975, the Commission proposed a directive with a set corporate tax rate, a partial imputation system, and a common withholding tax on dividends but the proposal was withdrawn in 1990. A proposal to harmonize the rules for carry-forward of losses was presented in 1984/1985 but was later withdrawn. The first proposal to harmonize the corporate tax

[130] Radaelli, *Corporate Direct Taxation in the European Union: Explaining the Policy Process*', Journal of Public Policy, vol 15, no. 2, 1995 p.163.

[131] Vienna European Council 11 and 12 December 1998, Presidency Conclusions, pt. 21.

[132] Europäische Wirtschaftsgemeinschaft, *Kommission: Bericht des Steuer- und Finanzausschusses* (Neumark Bericht), Brussel, 1962.

[133] Tempel*, Impôt sur les sociétés et impôt sur le revenu dans les Communautés européennes*, Luxembourg CE, 1970.

base came in 1988 but the draft was never officially presented due to the reluctance of the member states to incorporate these kinds of rules.[134]

All of these initiatives were either withdrawn or rejected due to the lack of support by the member states. The lack of progress contributed to the Commission’s shift of focus of a different approach to the problems based on three new ideas. The Commission expressed that direct tax measures should aim at the completion of the internal market, that they ought to be consistent with the principle of subsidiarity, and that all initiatives ought to be defined through a consultative process with the member states.[135] This resulted in the adoption of the Merger Directive[136], the Parent-Subsidiary Directive[137], and the Arbitration Convention[138] in 1990.

4.3.2 The History and Future of the CCCTB/BEFIT

As mentioned in the section above, the first attempt to harmonize the corporate tax base came in 1988.[139] The motif of the proposal was among others, the concept that the internal market could not function properly without rules connected to the harmonization of corporate taxation as none of the free movements could be used to its full extent if the fiscal conditions of the member states varied drastically from each other.[140] Two other objectives the Commission wanted to achieve with the directive were the heightened transparency to the regimes of the enterprises and making the fiscal compliance regime less complex and more stable for the enterprises.

[134] Commission of the European Communities, *Commission Staff Working Paper: Company Taxation in the Internal Market*, SEC (2001) 1681, Brussel, 23 October 2001, p.16-17.
[135] Commission of the European Communities, *Commission communication to Parliament and the Council: Guidelines on company taxation*, [SEC (90)601], Brussel, 1990, p.10-11.
[136] Merger Directive, Council Directive 90/434/EEC of 23 July 1990.
[137] Parent-Subsidiary Directive, Council Directive 90/435/EEC of 23 July 1990.
[138] *Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises*, [COM (90/436/EEC].
[139] 7 Commission des Communautés européennes, *Projet de proposition de directive concernant l’harmonisation des règles de détermination des bénéfices imposables des entreprises*, Bruxelles, 8 Novembre 1988. Note, unpublished and only available in French.
[140] Directive concernant l’harmonisation, p. 2.

The Commission argued in the proposal that the directive could potentially increase the competitiveness of the Union enterprises compared to foreign and that while the rules would be common for all member states, the member states would still have a broad margin in terms of the application of the rules, tax credits and granting of subsidiaries. However, the directive was blocked before even becoming an official Commission proposal. [141]

The second time a proposal for a common corporate tax base was presented, was in 2011.[142] The proposal's primary goal was very similar to the proposal of 1988, to remove the obstacles to the completion of the internal market and to stimulate growth and work creation.[143] However, the CCCTB differed drastically on one point, in contrast to the 1988 proposal which set a mandatory tax base the CCCTB tax base was optional. The CCCTB would ensure consistency in the national tax regimes, yet would not harmonize the tax rates. The Commission maintained that fair tax competition between member states was encouraged but that the member states would benefit from the introduction of an already determined margin of tax base rate.[144] The proposal was later blocked by the Council as no visible progress was made since its launch in 2011.[145]

In 2016 two proposals were officially presented, the CCTB[146] and the CCCTB[147]. The Commission expressed the need to re-launch the 2011 CCCTB proposal as a way to holistically approach profit shifting. The Commission acknowledged that new issues had arisen since 2011 which needed to be addressed with a common approach. While the previous

[141] Directive concernant l'harmonisation, p.2-4.

[142] European Commission, *Proposal for a Council Directive on a Common Consolidated Corporate Tax Base*, (CCCTB), COM (2011) 121/4.

[143] CCCTB, 2011, p. 4.

[144] CCCTB, 2011, p. 4-5.

[145] 'Legislative train schedule', European Parliament, 2018, retrieved 23 April 2018, http://www.europarl.europa.eu/legislative-train/theme-deeper-and-fairer-internal-market-with-a-strengthenedindustrial-base-taxation.

[146] European Commission, *Proposal for a Council Directive on a Common Corporate Tax Base*, COM (2016) 685 final.

[147] European Commission, *Proposal for a Council Directive on a Common Consolidated Corporate Tax Base*, (CCCTB), COM (2016) 683 final.

proposals on the matter were mainly concentrated on solving issues of compliance for enterprises operating in the union the new proposals from 2016 focused on the fight against profit shifting and tax abuse.[148] Taking into account the previous failed attempts to introduce a common corporate tax base, the Commission opted for a two-step approach, where the CCTB would constitute a bridge towards the real goal of an implementation of the CCCTB.[149]

The CCTB was limited to only determining the common base including certain provisions against tax avoidance and on the international area the proposed tax regime. Furthermore, two new areas were introduced compared to the CCCTB proposal from 2011, rules against debt bias and super-deduction for research and development.[150] The next step in the two-step approach was the introduction of the CCCTB which focused on the facilitation of business within the union while making the system more robust and resilient to aggressive tax planning. The CCCTB would allow enterprises to compute the corporate tax base of an entire enterprise group and would appoint the consolidated tax base to each of the eligible member states.[151] The biggest difference from the 2011 proposal was that the CCTB and CCCTB would be mandatory for all MNEs and optional for small enterprises, the reason for this was that the mandatory requirement for MNEs would address the issues of tax avoidance and evasion while the optional alternative for small enterprises would boost their growth and potentially remove remaining obstacles in the internal market for cross-border activities.[152]

In their communication, the Commission stated that they would replace the pending CCTB and CCCTB proposals from 2016 with a new proposal in

[148] CCCTB, 2016, p. 7.
[149] See CCTB, 2016, p. 3 and European Commission, *Communication ''A Fair and Efficient Corporate Tax System in the European Union: 5 Key Areas for Action'*, COM (2015) 302 final, Brussels, 17 June 2015, p. 8.
[150] CCTB, 2016, p. 3.
[151] CCCTB, 2016, p. 13.
[152] CCTB and CCCTB, 2016 p. 3 & 5.

2023.[153] The new proposal named Business in Europe: Framework for Income Taxation (BEFIT) is an attempt to build upon the current discussions in the international tax arena about Pillar One. The new BEFIT proposal has the same aim as it historically has had, the introduction of a single corporate tax base system within the union, but borrows concepts and features both from the previous CCCTB proposals and also the OECD's Pillar One and Two.[154] As the previous proposals, the BEFIT will consolidate the profits of corporate groups in the union into a single taxable base which would, later on, be allocated to member states using a formula and lastly taxed at national corporate income tax rates.[155]

The Commission stated that the new BEFIT rules would encourage European enterprises to conduct business in multiple member states by allowing consolidation of profits and losses across the EU market and by creating a common rulebook for the union which would reduce the compliance costs for MNEs and tax authorities. The Commission once again expressed that the lack of harmonization on the field of corporate taxation in the union negatively impacts European business and the tax revenue for member states. Furthermore, the Commission pressed on the need for a common corporate tax base to combat the aggressive tax planning schemes which benefit from the current mismatches between corporate tax regimes within the EU and undermines the member states right to collect revenues which could further fund the recovery of the economy and social security measures.[156]

Consequently, the history of the CCCTB is long and fraught with difficulties. While it seems that most of the member states agree that the issues the proposal is targeting are real and important, the unanimity requirement blocks the way for the proposal to come to life. The main

[153] European Commission, *Communication from the commission to the European Parliament and the council: Business Taxation for the 21st Century*, COM (2021) 251 final, p. 12-13.
[154] European Commission, *Business Taxation for the 21st Century*, p.13.
[155] European Commission, *Business Taxation for the 21st Century*, p.12.
[156] European Commission, *Business Taxation for the 21st Century*, p.11-12.

objective of the different proposals has been to eradicate obstacles for MNEs in the union to promote growth. As the years have gone by new issues have arisen, another goal was added to the list, the fight against tax avoidance and evasion which became a big problem in the 21st century. The Commission hopes that the new discussions held at the international level at the OECD/IF will loosen the knots and allow all the member states to agree to the implementation of the BEFIT.

5 Issues of Compatibility Between Pillar One and Union Law

5.1 Introduction

This chapter examines the legal possibilities to implement OECD's Pillar One into the internal market through a directive. This part of the analysis is based on art. 115 TFEU and the principles of proportionality and subsidiarity. The discussion and conclusions are based on the Blueprint of Pillar One and the previous attempts of the EU to introduce CCCTB into the union. The second part of the analysis focuses on the compatibility of Pillar One with the freedoms of the Treaties as no legislation can be adopted if it impedes the fundamental freedoms or discriminates. This part of the thesis is based on the case-law of the CJEU. The structure of this section is similar to the CJEUs approach of an analysis of the compatibility of a national restrictive measure against the fundamental freedoms. Due to the fact that the proposal is still not fully agreed upon, the possible conflicts with Union law and the implementation difficulties are not set in stone and might change over time as the OECD presents their final version.

5.2 The Implementation of Pillar One Through a Directive

5.2.1 The Unanimity Requirement

Harmful tax competition is a worldwide problem that contributes to tax avoidance and evasion. To combat this problem many states have introduced different CFC rules and other security measures to find harmful tax planning schemes.[157] The EU has for the last decade had the ambition to make the internal market more harmonized in the field of direct taxation but

[157] See e.g., Cadbury Schweppes (C-196/04).

as the member states have broad sovereignty in this area it makes it harder to enact hard law initiatives.[158] The implementation of Pillar One at the OECD/IF level will be conducted through a multilateral convention which sets out the framework for the required legislation at the domestic level.[159] The EU has been effective in implementing other initiatives stemming from the BEPS project into union law e.g., by the adoption of ATAD in 2016. The EU Commissions President von der Leyen has indicated that the EU will implement Pillar One or other similar initiatives (BEFIT) into union law through a directive.[160]

As the EU has limited competence in the field of direct taxation, the directive would have to be adopted through art. 115 TFEU which requires unanimity. Art. 115 TFEU is the only available measure for positive harmonization of direct taxes within the union, therefore, it is of importance that none of the member states put forward their right to veto. The article empowers the Council to issue a directive for approximation of domestic tax laws if they directly affect the establishment or the functioning of the internal market.[161] Pillar One indirectly aims to curb tax avoidance and evasion by reforming the present international corporate tax rules to make the economy more resilient to aggressive tax planning while allowing market jurisdictions to cultivate a part of the profit originated from that specific state. The objectives of Pillar One directly impact the internal market as they change the allocation of taxing powers and eradicate distortions in the domestic systems which have been used in a negative way by MNEs.

[158] See art. 5 TEU & 3-4 TFEU which confirms that the EU has limited competence in the area of direct taxation and the member states have a right to veto any proposal.
[159] See section 2 & OECD, Statement, 2021.
[160] See e.g., European Commission, *Communication from the commission to the European Parliament and the council: Business Taxation for the 21st Century*, COM (2021) 251 final, p. 12-13. Where the Commission stated that they would replace the pending CCTB and CCCTB proposals from 2016 with a new proposal in 2023. The new proposal named Business in Europe: Framework for Income Taxation (BEFIT) is an attempt to build upon the current discussions in the international tax arena about Pillar One.
[161] See section 3.1. & art. 115 TFEU.

The unanimity requirement allows any member state to reject the implementation of a directive based on art. 115 TFEU which means that the proposal has to accommodate to at least 27 different interests and legislative systems. Within the union, there are a few states that have a low corporate tax rate which has objected to the harmonization and implementation of a minimal tax rate. For instance, Ireland is a low-tax regime which uses low corporate taxation to attract investments. It can be argued that low-tax states will reject the proposal of Pillar One as it would impair their positions as favourable investment states.

Another aspect is that the member states would give up some sovereignty with the implementation of Pillar One. This is a controversial topic as discussions have been brought forward of the EU having too much power and that giving up the field of direct taxation would diminish the sovereignty of member states as direct taxation is historically directly linked with it.[162] This unwillingness can be seen in the failed attempts of the EU to introduce the proposal of the common consolidated corporate tax base (CCCTB). While the proposal was first launched in 2011 and relaunched a few times, the latest 2020 under the new name BEFIT the proposal has not won over the member states. EU's vision has been to address the challenges of the mismatch of domestic legislation which allows aggressive tax planning schemes and double taxation, while simultaneously simplifying the compliance aspect of cross-border activities for MNEs.[163] The CCCTB/BEFIT rules have a lot in common with Pillar One which raises the question of why the member states would accept Pillar One if they for more than a decade have rejected CCCTB/BEFIT. One possible answer is that the

[162] See Follesdal, *Survey Article: Subsidiarity*, The Journal of Political Philosophy, 1998, p. 191. The principle of subsidiarity was introduced into the EU in the late 1980s as a response to the fears of centralized powers as it became apparent that the member states only enjoyed little exclusive legislative authority and that the Union would be able to legislate in any field of legislation if needed for specific internal matter ends. The fear was grounded in the vast amount of EU legislation produced from 1984 and onwards, hence contributing to a resistance from the member states and the introduction of the principle of subsidiarity in the 1992 Maastricht Treaty of the European Union (TEU) and further elaborated in the 1997 Protocol of the Treaty of Amsterdam.

[163] See section 4.3.

pressure put on them through the international community might speed the process and contribute to the acceptance of a directive. As most member states are included in the OECD/IF group most of the issues they have, have probably been discussed which implies that the main problems have been resolved. The reality of 27 different interpretations of Pillar One might also deter member states from rejecting the proposal as this would create unnecessary complexity and compliance issues and furthermore lead to a situation where investments in the union would potentially be more expensive and less attractive for MNEs than other parts of the world.

Regarding the field of direct taxation, most member states are of the opinion that the issues of the digital economy can be addressed through unilateral measures. This has been the case concerning the CCCTB/BEFIT rules and is one of the reasons why the proposal has not been accepted. Already a few member states have introduced domestic measures to combat the negative effects of digitalization, mostly in the form of digital service taxes. This demonstrates the willingness of some countries to introduce unilateral measures in the absence of an international or European proposal. At the same time, it displays the possibility and effectiveness of domestic rules, why the possibility of a solely domestic implementation could be at hand.

5.2.2 Principle of Subsidiarity

Legislation concerning internal market matters has to be adopted with the principle of subsidiarity in mind. The principle of subsidiarity requires the Union only to act if and in so far as the objectives of the proposal cannot be successfully achieved by the member states themselves and can therefore be better achieved by the union.[164] The principle of subsidiarity encompasses a comparative efficiency test which comprises of two other tests, the

[164] See e.g., Chalmers, Davies, & Monti, 2010, p. 361-363 & art. 5 TEU, which states that actions ought to be taken at the most immediate level of governance, furthermore it requires a higher degree of accountability and transparency of the public authorities. The principal confines EU law-making competences to ensure that the decisions that are taken are justified in the light of the possible alternative measures available at local, regional and national levels.

sufficient attainment or necessity test and the European Union added value test or better attainment test.[165] The necessity test comprises a negative and a positive component, the negative component questions on what grounds the member state could not accomplish the desired aims of the proposed action, and the positive component questions if the Union could better achieve the aims of the proposed action.[166] On the other hand, the better attainment test assesses which level of government can better achieve the aims of the proposed action and if the manifest advantages of union action should outweigh the loss of member states' competence.[167]

The EU has addressed harmful tax competition through a number of measures e.g., State aid rules, ATAD, and so on, but tax competition is still around creating distortions and eroding tax bases. By definition, tax competition has a cross-border dimension as some states use unilateral measures to offer favourable tax treatment as incentives to attract foreign investments simultaneously eroding other member states' tax base which causes a negative effect on that state's budget and social welfare. Some member states have introduced anti-avoidance rules (CFC rules) as a response to the problem, however, the issue is that these unilateral measures cannot be successfully applied if they restrict the fundamental freedoms which they in many cases disproportionately do.[168] These unilateral measures create a patchwork within the legal system which leads to a heavier workload for domestic tax authorities and additional compliance costs for MNEs which in turn has a negative effect on the economy. Furthermore, tax competition is a worldwide issue that cannot be successfully addressed through unilateral measures as it creates an unnecessary complexity of legal measures which are hard to overlook and mismatches and disproportions are created unintentionally.

[165] Gernat, *Interpreting Subsidiarity: How to develop into a constitutional principle?*, in Europeanisation of Private Law, 2013, p. 191–192.
[166] Follesdal, 1998, p. 193–194.
[167] Gernat, 2013, p. 192–193.
[168] See e.g., Cadbury Schweppes (C-196/04), Where the court found that the rules created a restriction on the freedom of establishment, although, the restriction was justified given the need to prevent tax avoidance.

Since harmful tax competition is a worldwide problem with political and societal issues that affect national budgets and welfare of member states and in turn also the EU as a whole, it can be argued that a directive would be the right way to go. The mere aspect that harmful tax competition is addressed and discussed in the OECD/IF, where more than 136 countries are involved implies that this issue needs to be addressed by the international community as a whole. Evaluating the already implemented BEPS actions, ATAD and DAC 3 in the union it can be argued that these directives had the anticipated effects and have been successfully integrated into the union without having a negative effect on the sovereignty of the member states. Consequently, the negative effects of countries not being able to tax MNES which derive profit in that state have a negative effect on the economy of that state which in essence affects other states and undermines the integrity of the tax system. Union action would allow for a coherent and coordinated action which would minimize the possibility of disproportions/mismatches, which in turn could be used for tax evasion, cease to exist. The EU has a wide margin of discretion in balancing out internal market interests and the interests of member states. Therefore, it can be argued that a directive implementing Pillar One into the union would be in accordance with the principle of subsidiarity.

Due to the nature and objectives of Pillar One, a directive on this matter would concern the internal market, as it affects the member states' fiscal powers and appears to safeguard the member states' budgets rather than serving an internal market interest.[169] Since the court has confirmed that the competence to harmonize legislation in matters of health, are *per se* justified and established the idea that when the union sustains competence, they are automatically in a better position to legislate.[170] It would not be implausible to conclude that the court would find Union action to be preferable and

[169] See e.g., OECD, Statement, 2021 & section 3.

[170] United Kingdome v. Council (C-84/94). In the case United Kingdome invocated an infringement of the subsidiarity principle concerning the Working Time Directive which was determined not to be in breach of the principle of subsidiarity.

therefore not in breach with the principle of subsidiarity especially considering that the court usually accepts the reasons given by the Council as sufficient to meet the requirements of the principle.[171] Considering the case-law of the CJEU or the lack of it, the court has been reluctant to address the issue of subsidiarity in cases where a claim of a breach has been invoked and has not annulled a measure for breach of the principle yet.[172] Therefore it can be argued that the Court would not go against the Parliament and the Council regarding this matter as well.

5.2.3 Principle of Proportionality

Legislation at the EU level has to be conducted in line with the principle of proportionality.[173] The principle of subsidiarity is closely linked with the principle of proportionality, which requires that the union legislation is appropriate for attaining the objectives and does not go beyond what is necessary to achieve these objectives. As the CJEU has stated in its case law, it leaves broad discretion to the legislature and only holds the legislation invalid in case of misuse of power by the legislature. [174] Therefore, it can be argued that the proportionality test concerning union

[171] See e.g., Netherlands v. Parliament and Council (C-377/98), where the Netherlands argued that the grounds of the directive provided few reasons why the objectives were better achieved at Union level, the court rejected the Dutch claims and stated that the reasons given by the Council were enough. The CJEU reasoned based on the advantageous position the EU had in terms of the action scale or effect.

[172] See e.g., the cases United Kingdome v. Council (C-84/94), Netherlands v. Parliament and the Council (C-377/98) and Chalmers, Davies & Monti, 2010 and Estella de Noriega, *The EU Principle of Subsidiarity and its Critique*, Oxford, Oxford University Press, 2002, where the authors suggest that the Court is unwilling to review violations of the principle as not to go against the other EU institutions.

[173] See art. 5.3 TEU, *Nold* (C-4/73) & *Fedesa* (C- 331/88). Where the principle of proportionality is expressed, confirmed and further elaborated by the CJEU. The principle of proportionality regulates the exercise of the EU legislator by setting boundaries on the institutions. The action of the EU institutions may not go beyond what is necessary, to achieve the objectives of the Treaties. The CJEU recognised the principle of proportionality as a general principle deriving from the rule of law in the *Nold* case and introduced the modern formulation of the principle as we know today in the *Fedesa* case.

[174] See e.g., Craig, p. 590-604; Chalmers, Davies & Monti, 2010, p. 879 *et seq* and Búrca, 1993, p. 115-126. Where the authors claim that there is a discrepancy between the case law of the CJEUs application of the proportionality test regarding Member states and its application of the principle with regard to the EU institutions. The proportionality test is applied in a strict manner in regard to member states' actions and the measure is considered to be unlawful unless the member state can establish that the measure is necessary to achieve a legitimate aim and that there does not exist less restrictive alternatives. The EU measure has to be "manifestly inappropriate" to be considered as unlawful.

legislation in contrast to member states' legislation, involves a lower threshold and allows a somewhat disproportionate legislation if the objectives are achieved.

The question of whether a directive on Pillar One would comply with the principle of proportionality depends on the carve-out and if the objectives cannot be met in another, less invasive way. It could be argued that the carve-out set at 20 billion EUR is too high as the EU in their proposals for CCCTB have advocated for a threshold of 750 million EUR, simultaneously, the profitability requirement of 10 per cent further delimitates the number of enterprises available for the new digital levy.[175] The carve-out affects a small number of MNEs in regards to the vast majority of enterprises that might fit one of the criteria set out in Amount A. Therefore, the carve-out might be objectively disproportionate, why a directive might not be in accordance with the proportionality principle. The Commission has claimed in their CCCTB proposal, that the carve-out targets only a specific group of MNEs which have the means to engage in aggressive tax planning schemes.[176] Considering that the Commission accepts legislation that has a disproportionate effect, it can be argued that Pillar One would be in accordance with the principle of proportionality as it delimitates the scope even more. Consequently, the idea is that the directive would only target tax evasion instead of also encompassing purely economic decisions.

The Commission has also expressed the view, that a directive on the matter of corporate taxation, is suitable and necessary to achieve the desired objectives.[177] As Pillar One does not harmonize the corporate tax base to the extent that it would be an impediment to the member states' taxing powers,

[175] See section 3 and 4.3.
[176] See section 4.3 and CCCTB, 2016.
[177] See section 4.3 and CCCTB, 2016, where the Commission expressed the need to re-launch the 2011 CCCTB proposal as a way to holistically approach profit shifting and focus on the fight against tax abuse as this could not be successfully with unilateral measures.

a directive would follow the same line.[178] Pillar One does not limit states taxing powers but extends them and the use of a directive would allow the member states to formulate the legislation in consonance with their own needs and interests. Consequently, the proposal would not go beyond the objectives of the OECD proposal, the objectives would be met with no palpable restriction on the taxing powers of the states.

While the Commission has consistently promoted the need for coordination in the field of corporate taxation, it has been a slow process where most proposals have failed and a consensus has not been reached between the member states.[179] Due to the fact that the CCCTB only intended to harmonize corporate taxation in the union in contrast to Pillar One which intends to meddle with the taxing powers altogether, it is doubtful whether a directive on Pillar One would be positively received. Although, allowing member states to implement Pillar One themselves would risk creating distortions, compliance issues and legal uncertainty within the Union. Some member states might not even implement the legislation and as Pillar One is not compulsory and would not have any legal consequences for that state. In contrast, a directive would be compulsory and if not implemented could still be invoked or have direct effect by both legal and natural persons of that state.

5.3 The Compatibility of Pillar One with the Fundamental Freedoms

Developing new taxation rules which have to accommodate most of the world's countries is not an easy task, an additional layer is added when the rules also have to comply with the rules of a political and economic union with several sovereign states. Introducing new rules into the European

[178] See OECD, Blueprint – Pillar One and Two, 2020, as Pillar one creates a new nexus which extends the state's taxing powers, while, Pillar Two introduces an equalization levy which would constrict the taxing powers.

[179] See e.g., section 4.3 for the attempts and reasons why a coordination of the corporate tax base has failed in the union.

Union is a complicated and long process even if the field concerned is not as controversial as the field of direct taxation. The result of OECD's six years of work is the two pillars, Pillar One and Pillar Two. As the focus of the thesis is Pillar One, Pillar Two will not be addressed.[180]

5.3.1 Discrimination and Restriction Analysis

Through its case law, the CJEU has developed a schematic approach to the discrimination and restriction analysis which consists of three steps and can e.g., be found in the cases of *Dameseaux, Baars, and Gebhard*.[181] Firstly, the court has to determine whether or not the circumstances in the present (or potential) case actualize any freedom of the Treaties.[182] To determine which of the fundamental freedoms can be actualized in the present situation, the issue has to be decided with consideration of the purpose of the legislation in question.[183] As previously stated, the aim of Pillar One is to achieve fair and just taxation of MNEs while allocating Amount A fairly among the market jurisdictions.[184] As Pillar One only concerns legal bodies and the scope is based on the global turnover and profitability rate of an MNE, it can be argued that the freedom of establishment potentially would be restricted, as the in-scope MNEs most likely conduct business worldwide through e.g., subsidiaries.[185]

[180] See section 1.2 & 1.5 for the purpose and delimitation of the thesis.
[181] See e.g., Dahlberg, 2020, p. 395 et seq; Lodin et.al, *Inkomstskatt: en lärobok I skatterätt Del 1 & 2, 18th edition*, Lund, Studentlitteratur, [2021] p. 23; Ståhl et al., *EU-skatterätt*, 3rd edition, Uppsala, Iustus, [2011] p. 70 et seq, Damseaux (C-128/08) paras. 27-30, Baars (C-251/98) paras. 28-31 & Gebhard (C-55/94) para. 37.
[182] See art. 18 TFEU, which contains the provision of the general prohibition of discrimination. The provision explicitly prohibits any kind of discrimination based on nationality, but is like the fundamental freedoms only applicable in cross-border situations between member states. The provision does not limit the scope of application of the founding treaties but only has independent relevance in situations governed by European Union law for which the Treaty lays down no specific rules of non-discrimination.
[183] See e.g., cases Test Claimants in the FII Group Litigation (C-35/11) para. 90 & Tesco-Global (C-323/18) para. 54.
[184] See section 3 and the OECD, Blueprint – Pillar One, 2020.
[185] See section 3.2 and 4.2.

The discrimination analysis can only be conducted if the case concerns a comparable situation.[186] The CJEU concluded in the cases *X Holding*, *Lidl Belgium*, and *Cadbury Schweppes* that the assessment must be made in the light of the objective pursued by the relevant provision.[187] Therefore, it is of importance to determine whether a subsidiary of a non-EU national can be considered to be in an objectively comparable situation with a subsidiary of an EU-national. According to the cases of *Avoir Fiscal* and *AMID*, different treatment of resident and non-resident MNEs are prohibited if the MNEs are in a comparable situation in relation to the matter concerned from an objective aspect. A permanent establishment, as a rule, entails a non-resident MNE to be considered as a resident of that particular state where the PE is situated.[188] When an enterprise intends to establish a subsidiary in one of the member states, it does so according to that state's laws and conducts business according to the laws of that state, independent of the parent enterprise tax domicile. Generally, there is no distinction made regarding the establishment of a subsidiary depending on the parent enterprise's nationality. Moreover, no formal differences connected to the nationality of the parent company affecting the operation of a subsidiary exist. Therefore, it can be affirmed, that a subsidiary affiliated with a non-EU national is in an objectively comparable situation to a subsidiary of an EU-national parent company.

The aim of Pillar One is to achieve a more equitable and efficient distribution of taxing rights and also to ensure that the profits are taxed where the economic business is conducted and where value is created. The proposed tax liability is based on the consolidated turnover of the MNE which results in an objectively distinctive criterion.[189] In several cases e.g.,

[186] See art. 18 TFEU. Discrimination usually occurs when a provision, practise or a tax treaty subjects a domestic and a foreign taxpayer of the member states to different treatment which may be discriminative in a way that is prohibited by TFEU. Prohibited discrimination occurs only when two comparable situations are treated differently or if two different situations are treated similarly.

[187] See X Holding (C-337/08 para 22; Lidl Belgium (C-414/06) para. 27. and Cadbury Schweppes (C-196/04) para. 47.

[188] See AMID (C-141/99) paras. 27-31 & Avoir Fiscal (C-270/83) para. 27.

[189] See section3.2. and art. 18 TFEU, which prohibits discrimination based on nationality.

Poland v. Commission, Vodafone, and Tesco Global which in turn builds on cases such as Banca Popolare di Cremona, the CJEU has accepted rules concerning progressive turnover-based taxes.[190] Additionally, the court found in the Vodafone case that the amount of turnover constitutes a criterion of neutral differentiation and a relevant indicator of a taxable person's ability to pay.[191] Therefore, objectively the scope would not be considered discriminatory as all MNEs regardless of nationality, could be affected by the rules if the requirements are met. If implemented into Union law, the rules derived from Pillar One could not be challenged by art. 18 TFEU as they would not be discriminatory. The discrimination may arise from the fact, that the majority of in-scope MNEs are located in the US, but not from the law itself.

Classification based on company size can affect non-EU nationals disproportionately which may constitute indirect discrimination. MNEs have the capacity to expand across borders which would imply that situations of cross-border activity would be differentiated from inbound activity as smaller enterprises do not have the same recourses. In *Humblot* and *Feldain,* the CJEU concluded that while progressive taxation is generally permissible the rules were intended to subject foreign goods to the higher tax rate and therefore the provisions were seen as in breach of the fundamental freedoms.[192] However, the connection between company size and nationality is attenuated, consequently, company size is a facially neutral rule.[193] The court came to this conclusion in the *Commission v. Italy* and *Commission v. Greece* cases where the court further confirmed that taxes which increased progressively in an amount according to an objective criterion were acceptable, provided that the system of taxation was free from

[190] See Poland v. Commission (C-562/19 P), Vodafone (C-75/18), Tesco-Global (C-323/18) & Banca poplare di Cremona v. Agenzia Entrate Ufficio Cremona (C-475/03).
[191] Vodafone (C-75/18) para. 49.
[192] See Michel Humblot v. Directuer des services fiscaux (C-112/84) paras. 3 & 14 and Feldain v. Directeur des services fiscaux du departement du Haut-Rhin (C-433/85).
[193] See e.g., Mason & Parada, *Company Size Matters*, 5 BRIT. Tax Rev. p. 610, 2019. Where the concept of facially neutral and facially suspect classification is examined. Facially suspect provisions are those that obviously or strongly correlate with nationality, in contrast to facially neutral rules which is harder to determine.

any discriminatory or protective nature.[194] This type of classification can incidentally correlate to nationality which it does in this case.[195]

Facially neutral rules that incidentally correlate with nationality are regarded as discriminatory only if the carve-out actually correlates to nationality in the majority of cases, this conclusion can be derived implicitly from the Hervis Sport case and explicitly from the Opinion of General Advocate Kokott.[196] Further, according to the case *Commission v. Spain* case and in Advocate General Sharpston's opinion, it can be drawn that the correlation between size and nationality has to be proven with firm evidence.[197] The question of whether or not the facially neutral carve-out would be discriminatory according to art. 18 of TFEU would have to be answered by the CJEU. As the subsidiaries of both EU and non-EU nationals will have to be treated equivalently, they would most likely find themselves in comparable situations which would lead to subsidiaries of non-EU nationals to be subjected to the new taxation rules. The most important question would be if this would apply to the vast majority of cases as it consequently would result in discrimination and henceforth be unlawful. Another important aspect to remember is that the CJEU has not applied the majority rule regularly, in the court's later decisions, Vodafone and Tesco-Global, the CJEU did not apply the majority rule established in the Hervis-Sport

[194] See Commission v. Italy (C-200/85) paras. 8 & 10 and Commission v. Greece (C-132/88) para. 17. Even though these cases concern taxes on goods, analogies can be made as the court conducts its analysis regarding the fundamental freedoms in similar ways. Furthermore, there are no relevant cases in the field of direct taxation

[195] See Devereaux & Simmler, 2021, where the authors' research suggests that mostly MNEs situated in the US would be affected by Pillar One.

[196] See Hervis Sport (C-385/12) paras. 30-39 and the Opinion of Advocate General Kokott, paras 39-46. The court concluded, that if the majority of the taxable persons belonging to a corporate group were subjected to the highest tax rate and were linked to enterprises established in other member states, that the application of the progressive tax scale on the total turnover would risk to particularly disadvantage companies with a foreign connection and consequently be discriminatory.

[197] See Commission v Spain (C-400/08), paras 58-62 and the Opinion of General Advocate Sharpston, paras. 56-61. Where large retailers faced significantly more obstacles to business establishment than small retailers but the provisions were facially neutral. The CJEU rejected the commissions arguments because the Commission failed to prove that the regulation actually affected non-nationals disproportionately. Neither the CJEU nor General Advocate Sharpston explained what kind of evidence was necessary or sufficient.

case.[198] It is uncertain if this rule has played its part or if the court would consider applying it regarding the new digital tax. On the other hand, there is an important difference between the three cases, in the latter cases, the calculations of the tax base and the owned tax were not based on the consolidated net sales of the corporate group. The new rules through Pillar One will largely resemble the situation in the case of Hervis-Sport case which could imply that the majority rule would be applicable.[199] Ultimately, the question of the applicability of the majority rule to the new digital tax will be subject to review by the national courts in the member states.

The main issue the CJEU would have to deal with is to determine if there is a comparable situation in the case. Concerning subsidiaries integrated into the EU, presumably, the CJEU would consider there to be a comparable situation between subsidiaries to non-EU and EU parent companies. However, the situation is not as clear regarding MNEs without a subsidiary in the EU but who according to Pillar One would have a market in the EU and therefore a digital PE.[200] These MNEs would not be granted the same rights as MNEs in the union, as they do not meet the requirements of the TFEU. Consequently, non-EU MNEs would not have the protection that the prohibition of discrimination or the other fundamental freedoms grants both natural and legal bodies of the union.[201] Furthermore, it would theoretically be possible to discriminate against these MNEs in all matters except capital movements as the fundamental freedoms and art. 18 TFEU are only applicable in intra EU situations. The creation of a new digital PE, which

[198] See Vodafone (C-75/18), Tesco-Global (C-323/18) & Hervis Sport (C-385/12).

[199] See section 3.2, OECD, Blueprint – Pillar One, 2021 and Hervis Sport (C-385/12). Hungary had a graduated net turnover tax, which applied higher turnover tax rates to companies with higher net turnover. As a result, companies that were members of corporate groups were more likely to be subject to higher tax rates under Hungary's system, than companies that were not members of corporate groups. Pillar One will be based on a MNEs global turnover which implies that companies that are members of larger corporate groups will likely be in scope for the new digital levy.

[200] See Tesco Global (C-323/18), where the court concluded that there is a possibility for an enterprise to invoke a restriction on the freedom of establishment for another enterprises with which the former is associated with in the event that the restriction affects the first mentioned enterprise's own taxation.

[201] See section 4.2 and the articles 18, 28, 45, 56 and 63. Only an enterprise or subsidiary established in the union in accordance with the national legislation of a member state have the possibility to invoke the articles and receive protection for possible negative treatment.

does not require a physical presence in terms to grant the right to tax to a jurisdiction, will raise the question of whether or not physical and digital PE could be treated equally.[202] Therefore, the question arises whether or not the CJEU would treat physical and non-physical PE similarly. As there are a number of differences between physical and non-physical PEs, both from an economic but also a compliance perspective, it is difficult to imagine that the CJEU would consider physical and non-physical PEs to be in a comparable situation. Additionally, the case-law of the CJEU has developed a requirement of a physical presence to constitute a PE which would require the CJEU to change its position on the matter.[203] Until the CJEU receives a case in the court regarding this question the situation will be unpredictable as to whether or not there is a comparable situation. If the situation is deemed to be non-comparable then there is no discrimination issue at hand.

The new digital tax would most likely not be challenged by art. 18 TFEU as the rules are objectively neutral and it is uncertain whether the CJEU would apply the majority rule on this situation. Therefore, the compatibility issue can be further examined through the application of the freedom of establishment as the fundamental freedoms include both a prohibition of discrimination and a non-discriminative impediment.

General advocate Jacobs stated in his opinion in the *Danner* case, that in a number of recent cases, the CJEU has avoided assessing whether the domestic rules at issue were discriminatory and only referred to them as an obstacle or as a difference in treatment which might be justified by mentioned grounds in the Treaty.[204] Consequently, no comparison between persons is necessary since all restrictions imposed have a disadvantage for operations in a cross-border setting. As discriminative and restrictive measures are often closely linked the CJEU has in their recent case law

[202] See section 4.2 and art. 49 TFEU.
[203] See e.g., Factortame (C-221/89), Fitzwilliam (C-202/97) and Commission v. Germany (C-205/84), where the CJEU has stated that the freedom of establishment requires a physical presence in a member state for the provision to be applicable.
[204] Opinion of General Advocate Jacobs, Danner (C-136/00) paras. 35-41.

favoured the restriction analysis, therefore making it unnecessary to interpret art. 18 TFEU since all the fundamental freedoms provide for a prohibition on restrictions for the right to exercise the freedoms of the Treaty.[205]

The scope of Pillar One is relatively narrow as it only applies to MNEs that have a global turnover above 20 billion euros and a profitability rate above 10 per cent.[206] Consequently, only a few MNEs will be affected by the new rules. [207]A few of the MNEs that most certainly would meet the requirements of Pillar One are Google, Amazon, Facebook, and Netflix which all have their headquarters outside of the EU. As most of the in-scope MNEs are located outside of the EU it can be questioned whether a global turnover-based tax is designed in such a way that it would impede the fundamental freedoms, since it would mainly affect MNEs affiliated with parent companies outside of the EU. The fundamental freedoms have the aim of securing and governing the internal market of the Union which implies that discrimination against third countries is essentially permissible unless it concerns capital movements.[208] Furthermore, discrimination and restrictions on the fundamental freedoms are prohibited towards subsidiaries to parent enterprises established in third countries, which have been established according to the national legislation of a member state. [209] Therefore, the subsidiaries to parent enterprises outside of the EU are

[205] See section 4.2 and articles 28, 45, 49, 56, 63 TFEU. This prohibition is extended to both restrictions and non-discriminative impediment on the rights provided by the fundamental freedoms.

[206] See section 3.2. and OECD, Statement, 2021. The new nexus, according to which the new taxing right will be granted to states, will only be established in market jurisdictions where the in-scope MNE derives a minimum of 1 million euros in revenue in that jurisdiction alone. Market jurisdictions that have a GDP lower than 40 billion euros will proportionally have a lower threshold, set at 250 000 euros to qualify for the allocation of Amount A.

[207] See section 5.3.3. and Devereux & Simmler, 2021. The research presented by Devereux and Simmler shows that around 100 of the world's 500 largest MNEs will be in-scope of Pillar One. Of these MNEs only a few have their headquarters in Europe as most of them are located in the US.

[208] See section 4.2 and art. 63 TFEU. The freedom of capital movement can be applicable on situations concerning movement of capital between member states and third countries.

[209] See section 4.2, Kronos (C-47/12) para. 46 and Helminen, 2018, p. 96.

granted the same treatment as subsidiaries to parent companies within the EU.

As the scope of Pillar One is narrow and the carve-out thresholds are set high, only the most successful enterprises will be in scope for the new legislation.[210] To be able to reach these thresholds, an enterprise is inevitably required to conduct business globally and because the tax liability is calculated on an MNEs global turnover, it is of importance to determine the percentage of ownership or control the parent enterprise has over its various subsidiaries or branches.[211] Provided that the MNEs which are primarily assumed to be liable for tax under Pillar One have their registered offices outside of the EU and that they hold wholly-owned subsidiaries in the EU, inter alia, under those circumstances, the majority holdings mean that the parent enterprise has a significant influence of the subsidiary. Considering the cases of *Hervis Sport*, *X & Y,* and *Baars* which all concerned the freedom of establishment versus the freedom of capital movements, the amount of influence was the determining factor in the consideration of which of the freedoms that would prevail. If the subsidiaries are wholly owned and established in accordance with national legislation, the issue at hand does not concern pure capital movements. [212] Consequently, the situations fall within the scope of art. 49 and the freedom of establishment. In regards to Pillar One, it is likely that the freedom of establishment and the freedom of capital movements will be invoked before the CJEU, hence the freedom of establishment would take precedence.

[210] See section 3.2 and OECD, Blueprint – Pillar One, 2020.

[211] See OECD, Blueprint – Pillar One, 2020, which elaborates further on the required calculations for Amount A. The percentage of shareholding the parent enterprise has over its companies affects both which branches and sales are included in the assessment. The obligation to provide a consolidated account arises when an enterprise group consisting of at least two different companies situated in two different countries are related to each other through ownership or control. The amount of control needed is generally achieved when the parent enterprise owns more than 50 per cent of the shares in the other enterprise or holds a majority of the voting rights.

[212] See e.g., Royal Bank of Scotland (C-311/97) para. 20, Tesco-Global (C-323/18) para. 54, Hervis sport (C-385/12) paras. 20-24, X & Y (C-436/00) paras. 66-74 & Baars (C-251/98) para. 22.

A provision does not have to be discriminative to be considered in breach of the fundamental freedoms of the Treaty, it is sufficient that the provision may impede the freedoms, which has been confirmed by the court in several cases e.g., Oy AA and Test Claimants. [213] The possible differentiated treatment may cause parent enterprises to avoid forming new or retaining existing subsidiaries. The provision does not have to lead enterprises to *de facto* refrain from forming, acquiring, or maintaining a branch or subsidiary in another member state, it is sufficient that the provision might cause such behaviour to be deemed incompatible with the Treaty.[214] Since the carve-out of Pillar One is based on a group consolidated turnover and the group is based on shareholding it would be more preferential for MNEs to establish an independent company instead of a subsidiary as the earnings would be split up and the MNEs would not be in scope of Pillar One.[215] However, it is questionable if an MNE would consider splitting up a company group or stop growing in a more traditional way of subsidiaries.

Additionally, there are a number of other reasons why the CJEU would not consider Pillar One to be in breach of the freedom of establishment. Based on the court's reasoning in the cases of *Vodafone* and *Tesco-Global* it can be argued that the specific nature of the structures and actors of the digital economy is the reason why a significant number of MNEs are liable for the new digital tax would be affiliated with parent enterprises outside of Europe.[216] The fact that U.S. enterprises have a global leadership position in

[213] Oy AA (C-231/05) para. 42 and Test Claimants in the Thin Cap Group Litigation (C-524/04) para. 62. It is not required to establish that the domestic provision or practise actually has had a negative effect on enterprises and refrained them from establishing, acquiring or maintaining a subsidiary in another member state.

[214] See e.g., Gebhard (C-55/94) para. 37; CaixaBank France (C-442/02) para. 11, Krankenheim Ruhesitz am Wannsee-Seniorenheimstatt GmbH (C- 157/07) para. 30, Schumacker (C-279/93) para. 49 and Vestergaard (C-55/98) para. 21. That confirms that any measure that impede, prohibit or render it less attractive to utilize the fundamental freedoms are considered as restrictions. The restriction does not have to result in a higher economic burden, any measure that subjects the taxpayer to a more burdensome procedure or more administrative requirements are determined to be in conflict with the TFEU.

[215] See OECD, Blueprint – Pillar One, 2020 and OECD, Statement, 2021, for more information on the considered calculations for Amount A.

[216] See Tesco-Global (C-323/18) para. 72 & Vodafone (C-75/18) para. 52, where the court stated that the fact that the greater part of those affected by the special tax were owned by natural persons or legal persons of other Member States could not by itself merit, categorisation as discrimination. This due to the fact that the Hungarian

digital technology implies that they will also constitute a predominant proportion of the in-scope MNEs. Therefore, it can be argued that it is a natural consequence that MNEs affiliated with certain states will be overrepresented in the liability for Pillar One. Furthermore, a group of subsidiaries can also independently from the parent company exceed the thresholds of Amount A which would render the subsidiaries liable for taxation according to Pillar One.

Considering the case law of CJEU, it is not implausible to assume that the court would determine that the provisions of Pillar One would not create a restriction on the freedoms of the Treaty. Although it cannot be excluded that the court could come to a different conclusion as the proposal of Pillar One is not fully agreed upon and some aspects of Amount A could change. However, to deepen the analysis and the reasoning behind an implementation of a directive of Pillar One, an examination of the justification grounds and a proportionality analysis is conducted.

5.3.2 Justification of a Restrictive Measure

According to the *Gebhard* case, if the CJEU would find the provision of Pillar One to be a restriction on the freedom of establishment it would have to determine if there is any reason to justify the provision.[217] A restriction on the fundamental freedoms in matters of direct taxation can only be accepted by a limited number of justifications. The rule-of-reason doctrine is only applicable to indirect discrimination and non-discriminative restrictions. The four criteria set out in the *Gebhard* case, have to be met for the provision to be justified. Considering the conclusions in the previous

telecommunications market was dominated by such taxable persons, who achieved the highest turnover in that market. Accordingly, the court determined that the situation was a fortuitous indicator, if not a matter of chance, and which may arise, even in a system of proportional taxation, whenever the market concerned is dominated by undertakings of other Member States or of non-Member States or by national undertakings owned by natural persons or legal persons of other Member States or of non-Member States.

[217] Gebhard (C-55/94) para. 37. The CJEU set out four criteria for justifying a restrictive rule that impede the fundamental freedoms. In exceptional cases the court has come to the conclusion that if the domestic rule is of national importance, it can in some instances outweigh the importance of maintaining the fundamental freedoms.

section, the provisions would not be discriminatory which results in the fact that the provisions have to be discussed in relation to an overriding public interest, according to the court in the *Gebhard* case. [218]

The justifications that have been accepted by the CJEU in matters of direct taxation are; the prevention of tax avoidance and evasion, the need to ensure a balanced allocation of taxing powers, the need to ensure the effectiveness of fiscal supervision, the principle of territoriality, and lastly the need to preserve the coherence of the national tax system.[219]

Competition between legal systems including tax competition is an integral part of the internal market. Hence, jurisdiction shopping is legitimate as the enterprise exercise their fundamental freedoms to take advantage of beneficial tax rules in other member states. Gaining preferential tax treatment is not the same as avoiding taxation at all, which is a legitimate ground for restricting the freedoms. The court concluded in e.g., the *ICI* case and further elaborated in the *Cadbury Schweppes* case that only purely artificial arrangements which have been organized with the sole reason of tax evasion are considered to be in breach of the exercise of the fundamental freedoms and therefore states can restrict the fundamental freedoms on the ground of tax evasion.[220] The term "wholly artificial arrangements" according to the CJEU contains an objective and a subjective element which has been further elaborated in the cases of *Halifax* and *Emsland-Stärke*. The subjective element requires an intention to obtain a tax advantage through the artificial conditions created by the person, which according to the court

[218] Gebhard (C-55/94) para. 37. The criteria that have to be fulfilled is that the domestic rule has to be applicable in a non-discriminative way, it has to be justified by an urgent public interest, be able to ensure the effective realization of the objectives pursued by the rule and do not go beyond what is necessary to achieve the desired goal of the rule.

[219] See e.g., ICI (C-264/96), Lankhorst-Hohorst (C-324/00), Marks & Spencer (C-446/03), Bachmann (C-204/90), Futura Participations (C-250/95), Bosal Holding (C- C-168/01)

[220] See e.g., Lankhorst-Hohorst (C-324/00) para. 37, ICI (C-264/96) para. 26 and Cadbury Schweppes (C-196/04) paras. 51 & 55. To be considered as a legitimate ground for justification the national rule has to target solely artificial arrangements. The rules are only justified in the situation that they target solely artificial arrangements which does not reflect the economic reality and has the purpose of evading the national tax due on the profits generated by the activities carried out on the territory of the state in question.

can be determined, inter alia, through the evidence of collusion. The objective element involves an examination of the objective circumstances of the case if determined that the purpose of the freedoms (in this case freedom of establishment) has not been achieved and that there is no genuine establishment and furthermore no actual economic activity in the other member state, the conduct is considered artificial.[221] The purpose of Pillar One is not to target artificial arrangements created for tax evasion which is the purpose of the BEPS-project but to adapt the international income tax system to the digital economy and improve tax certainty.[222] Considering that the in-scope MNEs liable for taxation, in most cases have a real financial base which has not been established for the purpose of tax evasion, the justification ground of tax avoidance is not relevant in this present case.

The justification to safeguard the balance of taxing powers amongst member states aims to justify a national restrictive measure that aims to curb tax planning structures that obstruct the right of a member state to tax economic activities carried out in its territory and was introduced in the *Marks & Spencer* case.[223] The maintenance of the balanced allocation of taxing powers has mostly been tried in conjunction with other justifications, however, it has been accepted as a separate justification ground in for example the cases *X Holding* and *National Grid Indus*.[224] Based on the rulings of the CJEU in the cases of *Oy AA* and *Rewe Zentralfinanz,* a restrictive measure can only be allowed if it is designed to prevent arrangements which may put the member states right to exercise their taxing

[221] See Cadbury Schweppes (C-196/04) paras. 64 & 68; Halifax (C-255/02) paras. 74–75 and Emsland-Stärke (C-110/99) paras. 52–53. One of the objective factors that is taken into consideration is the legal bodies' physical presence in terms of staff, buildings and equipment in that other member state. If these factors lead to the finding that the establishment is fictious and does not carry out any genuine economic activity, the enterprise is considered as artificial.

[222] See section 3.2 and OECD, Blueprint – Pillar One, 2021.

[223] Marks & Spencer (C-446/03).

[224] See X Holding (C-337/08) and National Grid Indus (C-371/10). The justification ground entails that a member state has the right to ensure that the income generated in that state, either by having a reasonable tie to the tax subject or the tax object or both, the state has the right to protect the tax claim through legislation. However, this premise is dependent on the fact that the national rules have to be in accordance with the principle of proportionality.

powers at risk in relation to activities carried out in its territory.[225] The rule has been successfully invoked by member states in connection with transfer pricing rules, however, Pillar One grants new allocation of taxing powers to market jurisdictions. Therefore, the provisions of Pillar One would contribute to the balancing of taxing powers amongst the member states.

In the *Bachmann* case, the justification ground based on safeguarding the coherence of the national tax regime was first introduced.[226] The court has since elaborated on the requirements for the justification ground in the cases of *Asscher* and *Manninen* concluding that the justification requires a direct link between a tax advantage which would compensate for the tax disadvantage imposed on the taxpayer.[227] From the case-law of the CJEU, it can be drawn that the court only considers a direct link to exist if the tax burden and the tax benefit relate to the same income and the same tax subject.[228] Consequently, it is doubtful if the CJEU would justify a restriction based on that justification considering that there would not be any tax advantage for the taxpayer which would be directly linked to the tax disadvantage that Pillar One would create.

Fiscal supervision is used as a justification for a restriction on the fundamental freedoms and was introduced in the *Cassis de Dijon* case but has since been invoked in several cases e.g., *Lankhorst-Hohorst* and *Futura*.[229] This justification ground has mostly been applied in connection to third countries when the case concerns an actor from a member state

[225] See Oy AA (C-231/05) para. 54, Rewe Zentralfinanz (C-347/04) para. 42 and Helminen, 2018, p.156-157. As the field of direct taxation is not harmonized, member states are free to define the criteria for allocating their taxing powers. However, they are not allowed to systematically refuse to grant tax advantages to a resident subsidiary on the grounds that income of the parent enterprise established in another member state cannot be taxed in the subsidiaries' residence state

[226] Bachmann (C-204/90).

[227] See Bachmann (C-204/90) paras. 21–23, Asscher (C-107/94) para. 58 and Manninen (C-319/02) para. 42.

[228] See e.g., Baars (C-251/98), Mannienen (C-319/02), Commission v. Hungary (C-253/09) and Marks & Spencer (C-446/03). Since the Bachmann case, the CJEU has been reluctant to accept a justification ground based on the preservation of the national tax regime unless the direct link has been considered to exist.

[229] See e.g., Cassis de Dijon (C-120/78) para. 8; Lankhorst-Hohorst (C-324/00) para. 44 and Futura (C-250/95) para. 31.

conducting business in a third country where the member state argues that the exchange of information is insufficient to grant some tax advantages available for domestic actors.[230] The exchange of information has been greatly developed through the years and is in place both within the EU and vis-à-vis third countries.[231] With the introduction of Pillar One, the reporting obligation for global platform operators will entail a more accessible way of gathering information about income derived for digital activities which will determine the MNE's possible tax liability. Consequently, the basis of effective fiscal supervision cannot justify a possible restriction on the freedoms as there are opportunities already present to gather and access economic information about MNEs, and with Pillar One these opportunities will be expanded.

Lastly, the concept of the principle of territoriality is that each state is only entitled to the tax income of a non-resident if that income has a connection to the state in question. This is a general principle of international tax law that is mostly used regarding non-residents as residents usually face a broader tax liability in their home state.[232] The justification on the ground of the principle of territoriality has only been addressed in a few cases by the CJEU, as the case *Manninen* and *Bosal Holding* but has not been dealt with in cases of direct taxation.[233] Due to the lack of case law regarding the principle of territoriality as a justification ground for a restrictive measure in the field of direct taxation, it seems implausible that the court would accept this justification ground as the sole reason. Considering that the CJEU has confirmed in the case *Futura Participations* that, a member state that

[230] See e.g., Futura (C-250/95) para. 31. The member state has the right to impose a measure which would enable the amount of both taxable income and associated losses to be determined in a clear and precise way.
[231] See Bachmann (C-204/90), Danner (C-136/00), European Council, *Council Directive (2011/16/EU) of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC*, 2011 and European Council, *Council Directive (2010/24/EU) of 16 March 2010 concerning mutual assistance for the recovery of claims relating to taxes, duties and other measures*, 2010. The justification ground has not been accepted by the CJEU if the state in question could use an alternative less restrictive measure, or in situations concerning intra EU cases, rely on the *Directive on Administrative Cooperation* and the *Recovery Directive.*
[232] Helminen, 2018, p. 162.
[233] See Manninen (C-139/02), Bosal Holding (C-168/01) and Helminen, 2018, p. 162-163.

consistently observes the fiscal principle of territoriality cannot be considered to breach the freedoms of the Treaty, it can be assumed that states who implement the directive on Pillar One would only observe their fiscal principle of territoriality and therefore would not be in breach of the fundamental freedoms.[234]

There is a fundamental tension between the business-driven purpose of the fundamental freedoms to achieve the objectives of the internal market and the taxation-driven purpose of Pillar One to safeguard the economic interests of member states. In the light of the conducted discussion, it is unlikely that any of the justification grounds except perhaps the prevention of tax avoidance and evasion may be accepted as justifications for a restrictive measure. Hence, it is unnecessary to examine whether Pillar One is conducted with the principle of proportionality in mind. Nonetheless, as the proportionality analysis is part of the restriction analysis, a short outlook on the issue will be made.

According to the developed approach through the case *Gebhard,* in the matter of the compatibility analysis of a national provision with the fundamental freedoms of the Treaty, the last step is to determine if the realization of the objective pursued by the provision does not go beyond what is necessary for the achievement of the objective.[235] Based on the cases of *Gebhard*, *Cassis de Dijon*, *Lankhorst-Hohorst*, and *Marks & Spencer*, if the provision goes beyond what is necessary then it cannot be justified and the provision would breach the fundamental freedoms even if the provision was of an overriding reason of general interest.[236] The objective of Pillar One is as mentioned before, to allocate new taxing powers to market jurisdictions which in turn would be able to tax a share of the MNEs

[234] See Futura Participations (C-250/95) para. 22. The grounds of fiscal territoriality and fiscal cohesion are closely related and are to some extent hard to differentiate as both concepts refer to the necessity to treat tax base increases and connected tax base reductions symmetrically within the state.
[235] See e.g., Gebhard (C-55/94).
[236] See e.g., Gebhard (C-55/94); Cassis de Dijon (C-120/78); Lankhorst-Hohorst (C-324/00) and marks & Spencer (C-446/03).

revenue attributable to the state in question.[237] The question of proportionality will mainly concern the carve-out of Pillar One, as if set too high it will only include a few MNEs which might not be proportionate regarding the global economy as a whole but setting the carve-out too low could create negative impacts for the economic growth as smaller enterprises would possibly perish under the new rules.[238] Another factor is that while the BEPS-project through which Pillar One developed, aimed at eradicating tax evasion and avoidance, Pillar One will not only target harmful tax competition but also other forms of tax competition which might be of beneficial value to economies and the internal market. In conclusion, it is hard to address the question of proportionality as the real effect of the provisions will only become apparent sometime after the implementation.

[237] See section 3.2 and the OECD, Blueprint – Pillar One, 2020.

[238] See OECD, Blueprint – Pillar One, 2020. Where it is expected that the compliance cost would be too great for smaller enterprises to handle.

6 Concluding Remarks

The digitalization of the economy has brought light to some issues regarding the possibility to tax MNEs, as they conduct business in a different matter than when the international corporate taxation rules were introduced. The present taxation rules rely on the fact that MNEs conduct business through a physical presence in a state which in turn grants that state the right to tax the income that physical presence generates. In today's digital economy MNEs have the possibility to conduct business without the need of a physical presence, consequently, they can generate a profit in a state without that state being able to tax that income. This problem has received a lot of attention in the international community, as the head of states consider that large MNEs are eroding tax bases and evading taxes, which has prompted the OECD to initiate a reform process that has led to the proposals of Pillar One and Two.

The main solution to this problem is according to the OECD/IF, Pillar One which introduces a new type of a permanent establishment which does not rely on a physical presence. The in-scope MNEs will be determined by a global turnover threshold and a profitability threshold rate, while the taxation right will be granted to states where the in-scope MNEs generate at least 1 million euros in revenue or 250 000 euros in states with a GPD lower than 40 billion euros. According to the OECD/IF, these rules will be a great addition to the already existing rules and capture all MNEs which do not fit in with the present taxation rules. As a number of states have already introduced unilateral measures and both the United Nations and the EU have either introduced or proposed to introduce similar measures to combat the problems of digitalization, all eyes are directed at the OECD/IF discussions as they are seen as leaders of the international taxation field.

The EU has already addressed the implementation issue of Pillar One and confirmed that it would be implemented into the union through a directive. The implementation process would face several obstacles, mainly the unanimity requirement in art. 115 TFEU and the principles of subsidiarity and proportionality in art. 5 TEU. The unanimity requirement could be the downfall of a directive on Pillar One as any member state could use their right to veto to stop the implementation process. Regarding the fact that the Commission has since 2011 tried to implement similar legislation, in the form of CCCTB, in the EU and failed, the future seems grim. As the field of direct taxation is so closely linked to state sovereignty most countries are unwilling to give it up to the EU.

Furthermore, the directive would have to comply with both the principle of subsidiarity and proportionality. The main argument for the implementation of Pillar One through a directive is that unilateral measures would fragment the internal market even more and harmful tax competition is a worldwide problem that cannot successfully be addressed by unilateral measures. A directive would allow a coherent implementation and a smooth transition into the new rules. The principle of proportionality requires the directive to not go beyond what is necessary to achieve the objectives. As the objectives of Pillar One are to balance the taxing powers of states and to curb down tax evasion, two objectives that are important to the EU, it can be argued that it would not go beyond the necessity. Member states would not be restricted in their right to determine tax rates and would even have their taxing rights broadened.

Additionally, MNEs liable for the new tax could invoke the fundamental freedoms before the CJEU and argue that the directive impedes the exercise of the fundamental freedoms. The analysis of Pillar One contra the fundamental freedoms has revealed that Amount A, as it is constructed in the Blueprint is not discriminatory. As we have seen in the analysis, classification based on company size is a facially neutral rule which in this case happens to disproportionately affect non-EU MNEs. The carve-out is based on objective elements which would be applicable to all enterprises that meet the legal conditions of Amount A. Therefore, tax legislation in accordance with Pillar One Amount A would not in fact give rise to direct discrimination based on nationality. However, the fact that most of the in-scope MNEs would be affiliated with parent enterprises outside of the EU could potentially change the outcome, if the CJEU applies the majority rule derived from the *Hervis Sport* case.

The provisions of the fundamental freedoms do not require a comparable situation and it is sufficient with an impediment on the fundamental freedoms. As has been established in the analysis, a provision does not have to *de facto* lead enterprises to refrain from forming, maintaining, or acquiring a subsidiary in another member state as it is sufficient that it may cause this type of behaviour to be considered in breach of the fundamental freedoms. Upon further examination, it can be determined that Pillar One would not create an obstacle to the freedom of establishment as it is questionable if MNEs would change their behaviour to evade the tax liability created by Pillar One. Further, it was argued that the specific nature of the digital economy leads to the disproportionate outcome of the carve-out which would be a natural consequence of Pillar One and not a deliberate intention, which correlates to the court's findings in the cases of *Vodafone* and *Tesco Global*. Consequently, it can be determined that Pillar One would not create a restriction on the fundamental freedoms of the Treaty.

As it is determined that Pillar One would not be discriminatory and would not create a restriction on the fundamental freedoms the question of justification and proportionality was only shortly discussed in the analysis. The four grounds the CJEU has accepted as justification in the field of direct taxation were determined to be insufficient to justify a restriction on the freedom of establishment. The only justification that would potentially be accepted in a case where Pillar One is determined to restrict the freedom of establishment was the ground of prevention of tax avoidance and evasion. Lastly, the question of proportionality was addressed. The main issue with

Pillar One would be the carve-out as it could be seen as too narrow regarding the present information and it also targets not only artificial arrangements in order to evade taxation but also economically defensible arrangements. It is difficult to address the question of proportionality within the restriction analysis as not all details have been revealed and the real effect of the provisions will only be seen after its effect.

Therefore, it can be concluded that a directive on Pillar One would be in accordance with the union law and would be the best way to go forward with the implementation of Pillar One. The proposal has its flaws and might have some compliance issues regarding the CJEU future assessments but as there is no ready proposal within the EU and the rules need to change to adapt to the digitalization, it is a robust proposal that could successfully achieve its objectives.

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