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

Severin Schragl

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I. General Overview

A. Background

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

2 As a result, the following four instruments form the foundation of the EU legal system: TEU,[1] TFEU[2] (which is an updated version of the EC Treaty), EAEC Treaty (updated version), and the Charter of Fundamental Rights (hereinafter Charter). Together, the Treaties and the Charter form EU primary law. An inherent aspect of EU primary law is the general principles[3] on which the EU legal system is based. They have played a key gap-filling role that ensures the coherence of the EU legal system and are taken into account when EU law as well as national law measures are interpreted.[4] As of now, many of those principles have been codified within the Charter. They may act as an instrument when pursuing "negative integration". "Negative" integration describes the prohibition of illegitimate

1 Consolidated version of the Treaty on European Union, OJ C 326 of 26 October 2012.
2 Consolidated version of the Treaty on the Functioning of the European Union, OJ C 326 of 26 October 2012.
3 E.g. the principle of equal treatment. See, for example, CJEU, 22 November 2005, Case C-144/04, *Werner Mangold v. Rüdiger Helm*, ECLI:EU:C:2005:709.
4 Lenaerts/Gutiérrez-Fons, The Constitutional Allocation of Powers and General Principles of EU Law, *Common Market Law Review* 47/6 2010, pp. 1629–1669.

obstacles in the way of the four freedoms or the general principles, respectively (see also m.no. 22).

EU primary law is supplemented by secondary law which is law made by the EU institutions in the exercise of the powers derived from primary law. It consists of the following legislative acts (Art 288 TFEU):

- Regulations: Regulations in the EU apply automatically and uniformly to all EU countries as soon as they enter into force. Transposition into domestic law is not necessary and even forbidden.[5]
- Directives: Directives set certain results that have to be achieved by Member States. The Member States themselves must implement appropriate measures to achieve these goals within a certain timeframe and within the legal framework that has been agreed upon. Due to their precise and unconditional nature, they may be self-executing (see m.no. 15).
- Decisions: A decision is a binding legislative act by institutions of the EU. It needs no transposition into domestic law and, according to its specifications, it may only apply to certain individuals or states.

Additionally, the EU makes use of soft law that consists of non-legislative acts (recommendations, opinions, etc.). The case law of the CJEU is in practice also part of the EU legal system. Lastly, international treaties signed by the EU are also considered to be a part of the EU legal network.

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

4 Taxation is often seen as a potential obstacle to achieving a harmonized internal market and, as a result, is susceptible to infringing the fundamental freedoms. It may distort competition. This is the main reason for a number of directives and

5 CJEU, 10 October 1973, Case C-34/73, *Fratelli Variola Spa v Amministrazione delle finanze dello Stato*, ECLI:EU:C:1973:101.

regulations in the area of taxation in the EU. However, harmonisation has only been achieved in the field of indirect taxes whereas direct taxation is still largely subject to different national regimes. This means that certain distortions have to be accepted, especially since EU legislation relies on the Member States' unanimity (see m.no. 18). Moreover, despite the absence of a common tax policy, there seems to be a trend in issuing directives on income taxation of large multinational enterprises (see Chapter 3, m.no. 174, 178, 199).

B. Effects of EU Law

1. Supremacy

5 As the TFEU does not regulate the relationship between EU law and national legal orders, the CJEU has determined the nature of their mutual relationship. It came to the conclusion that EU law takes precedence over domestic law, subsequently coining the term supremacy. In early case law, the Court made it clear that "*the Community constitutes a new legal order …*"[6] and "*… the law stemming from the Treaty … could not … be overridden by domestic legal provisions …*"[7] – in the event of a conflict between an EU law provision and a national provision, the former takes precedence over the latter. Later, the Court further clarified that every national Court is obligated to apply EU law "*in its entirety and protect rights which the latter confers on individuals and must accordingly set aside any provision of national law which may conflict with it, whether prior or subsequent to*" the EU law provision.[8] The former national provision, however, is not invalidated but rather set aside as far as it conflicts with an EU provision.[9] This precedence also applies over a national constitutional provision.[10] According to the subsequent jurisprudence of the CJEU, national administrations are also required to ensure the supremacy of EU law over national law.[11]

2. Direct Effect

6 Depending on the nature of the provision, both primary and secondary EU law may have direct effect. A "directly effective provision"[12] of EU law confers "legally enforceable rights" on an individual in the way that that individual may rely on those rights before a national Court or a national administrative authority. As a

6 CJEU, 5 February 1963, Case 26-62, *NV Algemene Transport- en Expeditie Onderneming van Gend & Loos v Netherlands Inland Revenue Administration*, ECLI:EU:C:1963:1.
7 CJEU, 15 July 1964, Case C-6/64, *Costa v E.N.E.L.*, EU:C:1964:66.
8 CJEU, 9 March 1978, Case C-106/77, *Simmenthal,* EU:C:1978:49, para. 21.
9 CJEU,22 October 1998, Joined Cases C-10/97 to C-22/97, *Ministero delle Finanze v IN.CO.GE.'90 and Others*, ECLI:EU:C:1998:498, para., 21.
10 CJEU, 17 December 1970, Case C-11/70, *Internationale Handelsgesellschaft,* EU:C:1970:114.
11 CJEU, 29 April 1999, Case C-224/97, *Erich Ciola and Land Vorarlberg,* EU:C:1999:212.
12 Not to be confused with direct applicability which is widely used to differentiate between the need for implementation of directives as compared to regulations.

result of the supremacy theory, any national provision that is in conflict with the directly effective EU law provision in question has to be set aside by the Court or authority, respectively. The TFEU does not specify the direct effect of treaty provisions, directives, and international agreements concluded by the EU. For this reason, the Court has had to elaborate on these issues.

a) Direct Effect of the TFEU Treaty Provisions

The conditions for TFEU provisions having a direct effect were spelled out in the landmark case of *Van Gend & Loos*.[13] In the judgment, the Court held that the **EC Treaty constitutes more than an international agreement** since the Member States have limited their sovereign rights in certain fields by transferring powers to the EU institutions thereby creating a new, *sui generis*, system of law. The Court recognized that provisions of the Treaty can be directly effective and that there is no need to implement those provisions into domestic law. As a result, TFEU provisions can confer rights and obligations not only on Member States but also on individuals. **7**

In order to be directly effective, a TFEU provision has to fulfil the following conditions: **8**

- it must be **clearly** and **precisely** worded; and
- it must be **unconditional** and **independent** from any national implementation measure.

Individuals and other persons can therefore directly invoke TFEU provisions but only if the provisions meet the abovementioned conditions. **9**

b) Direct Effect of the EU Directives' Provisions

Since Member States are responsible for implementing directives into domestic law, there is an inherent risk that they will not be implemented or at least not correctly which might undermine the uniformity of EU law application. Without any further mechanism, this could lead to some Member States trying to circumvent the effect of the directive by simply not implementing it. Even in cases when the domestic legislator simply does not manage to implement the directive effectively, individuals would be deprived of their rights as set out in the directive. Therefore, it is important for individuals to be entitled, in any event, to rely on the original meaning of a directive provision. In the *Van Duyn* case, the Court ruled that "*it would be incompatible with the binding effect attributed to a directive […] to exclude in principle, the possibility that the obligation which it imposes may be invoked by those concerned. […] It is necessary to examine in every case, whether the nature, general scheme and wording of the provision in question are capable of* **10**

13 CJEU, 5 February 1963, Case C-26/62, *Van Gend en Loos,* EU:C:1985:104.

having direct effects on relations between Member States and individuals."[14] In the *Ratti* case, the CJEU established that Member States may not rely on a non-implemented directive against its own citizens (the *estoppel* principle).[15]

11 Generally, directives may not be applied directly in substantiating obligations to the detriment of an individual (**no reverse vertical direct effect of directive provisions**). However, when there is an abuse of law situation, an individual can be deprived of the EU law rights that are provided even if there is no specific legal basis under national law for such a denial. This is an important phenomenon in the area of direct taxation. Initially, the CJEU, referring to the anti-abuse provisions of the Merger Directive (Art. 15 thereof), ruled that a Member State that has failed to transpose the provisions of a directive into national law cannot rely upon limitations that might have been laid down on the basis of those provisions.[16] In an apparently striking departure from its previous case law, in the "*Danish*" cases,[17] the Court acknowledged that the prohibition of abusive practices constitutes a general principle of EU law. This decision leads to a convergence with VAT case law, in particular the seminal *Halifax* decision wherein similar Member States' rights were recognized.[18] Moreover, in *Italmoda*,[19] the CJEU ruled that Member States may deny rights granted under EU VAT law if the taxable person is participating or could have known it is participating in VAT evasion even if national law contains no basis for such a denial.

12 On the flipside, the Court clarified that an individual may rely on an unconditional and sufficiently precise provision of a directive if it provides individuals with rights, the time limit for implementation has elapsed, and the Member State has not implemented the directive[20] or has failed to do so correctly.[21] Consequently, Wattel argues that taxpayers are given a choice in that they can either apply the national provision that is contrary to EU law or refer directly to the directive provision. As a result, non-compliance of Member States may result in "provision shopping".[22]

14 CJEU, 4 December 1974, Case C-41/74, *Van Duyn v Home Office*, EU:C:1974:133.
15 CJEU, 5 April 1979, Case C-148/78, *Publico Ministero v Ratti,* EU:C:1979:110.
16 CJEU, 5 July 2007, Case C-321/05, *Kofoed*, EU:C:2007:408, para. 33.
17 CJEU, 26 February 2019, Joined Cases C-116/16 and C-117/16, *Skatteministeriet v T Danmark* (C-116/16), *Y Denmark Aps* (C-117/16), paras. 70–83.
18 CJEU, 21 February 2006, C-255/02, *Halifax and Others*, EU:C:2006:121.
19 CJEU, 18 December 2014, Joined Cases C-131/13, C-163/13 and C-164/13, *Staatssecretaris van Financiën, v Schoenimport 'Italmoda' Mariano Previti vof* (C-131/13), *Turbu.com BV* (C-163/13) and *Turbu.com Mobile Phone's BV* (C-164/13), EU:C:2014:2455. Similarly, in: CJEU, 22 November 2017, Case C-251/16, *Edward Cussens, John Jennings, Vincent Kingston v T.G. Brosnan*, EU:C:2017:881.
20 CJEU, 19 January 1982, Case C-8/81, *Becker,* EU:C:1982:7.
21 CJEU, 17 October 1996, Joined Cases C-283/94, C-291/94 and C-292/94, *Denkavit International, VITIC Amsterdam and Voormeer,* EU:C:1996:387.
22 Terra/Wattel, *European Tax Law* (2018) p. 71.

Individuals may not rely on a non-implemented or incorrectly implemented directive against another individual (no **"horizontal direct effect"**).[23] This possibility has been explicitly rejected by the CJEU. Two main arguments support this conclusion. First, the Court emphasized that a directive binds states and not private parties.[24] Second, the requirement for legal certainty prevents the directives from creating obligations for individuals without first being implemented into national law.[25] 13

Moreover, national Courts are obligated to ensure that the directive at issue is fully effective. This is achieved through **the principle of interpretation in conformity with EU law**. National Courts should follow the method of interpretation that best avoids inconsistency with EU law[26] both before and after the implementation period has expired.[27] In the doctrine, the principle is also known as the principle of consistent interpretation or of indirect effect. They are required to interpret national law in light of the wording and the purpose of the directive.[28] As such, it may affect private to private relationships. This principle of interpretation in conformity with EU law is applicable to the extent that national law provides discretion.[29] Therefore, an EU-conforming *contra legem* interpretation of national law is not permitted. Moreover, there is no obligation of consistent interpretation if such is contrary to general principles of law, particularly those of legal certainty and non-retroactivity.[30] 14

3. Direct Effect of the Provisions of EU International Agreements

Regarding international agreements, the Court has drawn on the doctrine developed in *Van Gend & Loos*. It confirmed the direct effect of specific provisions of EU international agreements as long as they are self-executing, i.e. they meet the two conditions outlined in the case (clear and precise wording as well as unconditionality and independence from national implementation, see m.no. 8).[31] In 15

23 In two exceptional instances, the CJEU did apply a horizontal direct effect between private parties in a civil proceeding. See CJEU, 30 April 1996, Case C-194/94, *CIA Security International SA v Signalson SA and Securitel SPRL*, ECLI:EU:C:1996:172 and CJEU, 26 September 2000, Case C-443/98, *Unilever Italia SpA v Central Food SpA*, ECLI:EU:C:2000:496.

24 CJEU, 14 July 1994, Case C-91/92, *Paola Faccini Dori v Recreb Srl*., EU:C:1994:292, paras. 22–23.

25 CJEU, 26 February 1986, Case 152/84*, M. H. Marshall* v *Southampton* and *South-West Hampshire Area Health Authority (Teaching), ECLI:EU:C:1986:84*, para. 48.

26 CJEU, 5 October 2004, Joined Cases C-397/01 to C-403/01, *Pfeiffer a. o.,* EU:C:2004:584, paras. 114–119.

27 CJEU, 4 July 2006, Case C-212/04, *Konstantinos Adeneler*, EU:C:2006:6057, paras. 114–117.

28 CJEU, 13 November 1990, Case C-106/89, *Marleasing SA v La Comercial Internacional de Alimentacion SA*, EU:C:1990:395, para. 8.

29 CJEU, 10 April 1984, Case C-14/83, *Sabine von Colson and Elisabeth Kamann v Land Nordrhein-Westfalen,* EU:C:1984:153, para. 28.

30 CJEU, 8 October 1987, Case C-80/86, *Kolpinghuis Nijmegen*, EU:C:1987:431, para. 13; CJEU, 4 July 2006, Case C-212/04, *Konstantinos Adeneler and Others v Ellinikos Organismos Galaktos*, EU:C:2006:443, para. 110.

31 Cf. CJEU, 30 September 1987, Case 12/86, *Meryem Demirel v Stadt Schwäbisch Gmünd*, EU:C:1987:400, para. 23.

addition, the Court added a third requirement that addresses the spirit, structure, and nature of the agreement which may not preclude their direct effect.[32]

16 In the context of the special role granted to the European Convention of Human Rights (ECHR) in the EU legal system,[33] the CJEU has reopened the debate on the relationship between international law and EU law. In addressing the effect of international agreements, the Court examines, among other things, whether a sufficient level of protection of the fundamental rights exists. In the *Kadi I* case, the CJEU reviewed the lawfulness of a legal act transposing a UN resolution, highlighting the insufficient protection of fundamental rights at the UN level. The balance between the need to combat international terrorism and the protection of the fundamental rights and freedoms of suspected terrorists within the EU legal framework was once again considered in the *Kadi II* case. The CJEU ascertained that the justification of adopting restrictive measures on an EU level has to be sufficiently reasoned and supported by evidence.[34]

4. Institutions

17 Art. 13 of the TEU establishes, *inter alia*, the following EU institutions: the European Parliament, the Council, and the European Commission. These institutions are the essential part of the EU legislature procedure and thus also influence EU direct taxation, although the powers in the field of direct taxation remain mostly in the hands of the Member States.

18 The **lawmaking procedure** varies by the subject of the legislation. The ordinary legislative procedure is the main procedure for EU decision-making. According to Art. 294 TFEU, it applies when referenced by the Treaties and starts with the Commission submitting a proposal (though specific exceptions exist within the Treaties). Subsequently, both the European Parliament and Council approve, reject, or propose amendments (first, second, and very seldom third reading/conciliation) until an agreement is reached. Depending on the stage (first or second and third reading), the required majorities in Parliament are either a simple or an absolute majority and, in the council, usually a qualified[35] majority.[36] Special legislative procedures as set out in Art. 289 (2) TFEU provide the council with the opportunity to act as the only legislator with a reduced role of the Parliament. In direct tax matters, a special procedure applies. It requires the unanimity of the

32 CJEU, 9 February 1982, Case C-270/80, *Polydor Limited and RSO Records v Harlequin Records Shops and Simons Records,* EU:C:1982:43, para. 12; CJEU, 11 May 2000, Case C-37/98, Savaş, EU:C:2000:224.

33 CJEU, 18 December 2014, Case Opinion 2/13, EU:C:2014:2454, para. 37 et seq.

34 CJEU, 18 July 2013, Joined Cases C-584/10 P, C-593/10 P and C-595/10 P, *Kadi II*, EU:C:2013:518, para. 163.

35 A qualified majority requires a majority of EU Member States of at least 55% and principally a majority of at least 65% of the EU's population. A blocking minority requires at least four Member States and 35% of the population of the participating countries + one country (Art. 16 TEU).

36 In procedural issues, however, simple majorities are sufficient while unanimity persists in sensitive areas such as finances, indirect taxes, and the common foreign and security policy.

council to issue a legislative act on direct taxes (Art. 115 TFEU). The European Parliament plays only a consultative role. Hence, with the ordinary legislative procedure, the peoples of the EU are directly represented through the EU Parliament acting as a co-legislator. Meanwhile, in tax matters, there is no accountability to the European people but to the European countries through the council and hence only indirectly to the people.[37]

19 The **European Parliament** and the **Council** can thus be seen as two chambers of the legislative branch of the EU with its competences being officially distributed between both institutions. Some relevant differences can still be noted in comparison to powers given to national legislatures. For instance, the power of legislative initiative is exclusively reserved for the European Commission.[38] Therefore, while the European Parliament and Council can principally amend and reject legislation, only the Commission can initiate the legislative procedure itself.

20 Besides its competences in the legislative process, the **European Commission** monitors the Member States' compliance with EU law. Whenever it finds that a Member State has not complied with EU law, it initiates an infringement procedure. The European Commission also has a special role within the area of state aid. New aid measures must principally be reported to the European Commission. Following the notification, the European Commission initiates a preliminary investigation to decide if a measure may be implemented. The European Commission is also competent to review the authorized aid schemes. In addition, it can examine aid granted without prior authorization (e.g. unlawful aid). If it has serious doubts about the aid's compatibility with EU state aid rules or when it faces procedural difficulties in obtaining the necessary information, it can initiate a formal investigation procedure (Art. 108(2) TFEU). Moreover, the Commission often issues non-binding soft law measures directed at the Member States.

21 The competent legislative arm of the EU – the **Court of Justice of the European Union** – has the function of ensuring that EU law is observed. It has the final say over how EU law is to be interpreted correctly. In doing so, the Court reviews the legality of the acts of the institutions of the European Union (including when it acts as an appellate body in respect of the decisions of the European General Court in domains such as, for instance, state aid), controls the Member States' compliance with obligations under the Treaties, and interprets EU law at the request of national Courts and tribunals with the aim of ensuring the uniform application and interpretation of EU law. In selected cases, it may also decide on

37 See Pistone, A Plea for Qualified Majority Voting and the Ordinary Legislative Procedure in European Tax Law, in: van Thiel/Valente/Raventós-Calvo (eds.), *CFE Tax Advisers Europe – 60th Anniversary Liber Amicorum* (2019) p. 33.

38 Few exceptions exist (see, e.g. Art. 30 TEU), albeit not with much relevance for the area of direct taxation.

the interpretation of a double taxation convention (hereinafter: DTC) as an arbitrator. This is only possible, however, when three conditions are met, specifically:

- The dispute brought before the CJEU is between Member States,
- the dispute relates to the subject matter of EU law; and
- the dispute is submitted to the CJEU under a special agreement between the parties.[39]

To date, the CJEU has acted as an arbitrator in respect of a DTC only once.[40]

II. Sources of EU Law

A. Primary Law

1. Fundamental Freedoms and State Aid

22 For many decades now, the most relevant primary law provisions have been the **fundamental freedoms** as interpreted by the CJEU (see Chapter 4, m.no. 201 et seq.). They essentially guard the internal market by setting limits to exercising national tax jurisdiction (known as **negative integration**).

23 More recently, legal acts that regulate the aid provided by a government and thus distort competition ("state aid rules"; Arts. 107 and 108 TFEU) have grown in importance. They have played an increasingly significant role in the field of direct taxes while judgments from EU Courts have determined the boundaries of the direct effect of such rules on direct taxes (see Chapter 5, m.no. 386 et seq.). The *Apple* case[41] has been the most prominent example of latest developments. However, the EU State aid rules as a "proper instrument" to harmonize tax legislation is currently seen very critically.[42]

24 Altogether, however, the scope of legislation in the field of direct taxation has remained sparse. This limited scope is usually explained in two ways. First, at the time the Treaty of Rome was signed, direct taxes were not seen as essential to the establishment of the internal market and, consequently, were left outside the scope of the EC Treaty.[43] This has not changed with the introduction of the TFEU. Second, having in mind that direct taxes may serve as useful tools in pursuing various economic or social aims, the Member States' reluctance to give up their competencies seems evident. As the individual Member States have already

39 Art. 273 TFEU.

40 CJEU, 12 September 2017, Case C-648/15, *Austria v Germany*, EU:C:2017:664.

41 CJEU, 10 September 2024, Joined Cases C-465/20P, *European Commission v Ireland and Apple*, EU:C:2024:724.

42 See the comments of AG Kokott cited by Wathelet, Recent Trends in ECJ case law, in: Kofler et al (eds.), *CJEU – Recent Developments in Direct Taxation 2024* (2025) p. 352.

43 It should be noted that the 1953 Tinbergen report laying down the conceptual grounds for the creation of the EC did not acknowledge harmonization of direct taxes as necessary in developing the single market.