Chapter 3: Corporate Tax Directives

3.1. EU Parent-Subsidiary Directive

3.1.1. Background

Force

A directive concerning the tax treatment of profit distributions between parent companies and subsidiaries of different Member States (the EU Parent-Subsidiary Directive) was issued on 23 July 1990. [652] The Member States had to bring into force the laws, regulations and administrative provisions necessary for them to comply with the Directive before 1 January 1992. The Directive also binds all the new EU Member States from the date of their accession. [653] The scope of the original version of the Parent-Subsidiary Directive was later extended with Directive 2003/123/EC. [654] The Member States had to bring into force the laws, regulations and administrative provisions necessary to comply with the amendments by 1 January 2005. A recast version of the Directive was issued at the end of 2011. [655]

Objective

The aim of the common tax system based on the Parent-Subsidiary Directive is to prevent tax measures of the Member States that constitute a disadvantage to cooperation between companies of different Member States compared to cooperation between companies of one Member State. The purpose is to facilitate the grouping together of companies of different Member States and to abolish tax obstacles on profit distributions between companies of different Member States.

Tax-exempt distributions

The aims of the Parent-Subsidiary Directive are implemented by exempting profit distributions from the withholding tax in the state of residence of the subsidiary and by eliminating both international juridical and economical double taxation in the state of residence of the parent company. The Parent-Subsidiary Directive allows tax-exempt profit distributions between subsidiaries and parent companies of two different Member States.

3.1.2. Scope of application

3.1.2.1. Profit distributions between subsidiary and parent companies residing in different Member States

Basic situation

The scope of application of the Parent-Subsidiary Directive is determined in Art. 1(1) of the directive. Each Member State applies the directive to distributions of profits received by companies of that state which come from their subsidiaries of other Member States. Each Member State must also apply the directive to distributions of profits by companies of that state to companies of other Member States of which they are subsidiaries. The directive has an impact on the tax treatment of intragroup distributions both in the state of residence of the distributing subsidiary and in the state of residence of the receiving parent company. The directive applies only to cross-border situations. Internal situations concerning only one Member State and cross-border situations where one of the companies is from a non-Member State fall outside the scope of application of the Directive. [657]

Dual-residence conflict

In a dual-residence conflict situation a distribution may come under the scope of application of the Parent-Subsidiary Directive even though the distribution would be made between a subsidiary and a parent company that are residents of the same Member State. The distribution made between the companies may come under the scope of application of the directive if one of the companies is considered to be a resident of another Member State because of a dual-residence conflict. Such a situation may emerge if the place of management of one of the

3.1.2.2. Profit distributions connected with a permanent establishment

Rule

Each Member State in which a permanent establishment is situated must apply the Parent-Subsidiary Directive to profit distributions received by the permanent establishments of companies of other Member States that come from their subsidiaries of a Member Sate other than that where the permanent establishment is situated. The directive must also be applied to distributions of profits by companies of that state to permanent establishments situated in another Member State of companies of the same Member State of which they are subsidiaries. [658]

TFEU compatibility
The freedom of establishment principle of Art. 49 of the TFEU requires that the cross-border situations in which the profit distribution is connected with a permanent establishment of a company of a Member State situated in another Member State come under the scope of application of the Parent-Subsidiary Directive. The permanent establishments of companies of Member States must be subject to equally beneficial tax treatment in the state in which they are situated as applies to the resident companies of that state. [659]

**Parent and subsidiary of the same state**

A distribution of profits may come under the scope of the Parent-Subsidiary Directive as a cross-border payment even though the parent company and the subsidiary company are from the same Member State if the profit distribution is connected with a permanent establishment situated in another Member State. In such a situation, both the state of residence of the subsidiary, which is the same state as the state of residence of the parent company, and the state in which the permanent establishment is situated must take the directive into account. [660]

**Three Member States**

The state in which the permanent establishment is situated must also take the Parent-Subsidiary Directive into account if the subsidiary and the parent company are from two different Member States and the permanent establishment is situated in a third Member State. The state of residence of the subsidiary must not levy a withholding tax on the profit distribution and the state in which the permanent establishment is situated must exempt the distribution or tax the distribution but grant an indirect foreign tax credit. [660] The state of residence of the parent company must also take the directive into account. [661]

**Permanent establishment in the subsidiary state**

It is somewhat unclear as to whether the Parent-Subsidiary Directive covers a situation in which a resident subsidiary of one Member State makes a distribution to its parent company, which is a resident of another Member State, but the distribution is connected with a permanent establishment of the parent company in the state of residence of the subsidiary.

It may be argued that the distribution in the situation described is an internal distribution in one Member State and not a cross-border distribution, even though the parent company is a resident of another Member State. In any case, the state of residence of the parent company must comply with the directive because from the perspective of that state there is a cross-border situation. From the perspective of the state of residence of the subsidiary and the state in which the permanent establishment is situated, which is the same state, it is an internal situation of that state and not a cross-border situation. This state may consider that, because there is no cross-border situation, the state is allowed to tax the distribution as an internal distribution irrespective of the existence of the Parent-Subsidiary Directive. The freedom of establishment principle of the TFEU, however, requires that the taxes levied in the case of the permanent establishment are not more burdensome than the taxes levied in the case of resident companies.

**Permanent establishment in a non-Member State**

A profit distribution made between a subsidiary and a parent company of two different Member States comes under the scope of the Parent-Subsidiary Directive even if the distribution would be connected with a permanent establishment that the parent company has in a non-Member State. The state of residence of the subsidiary and the state of residence of the parent company must comply with the directive. [662] However, the Parent-Subsidiary Directive does not oblige the state in which the permanent establishment is situated in any way.

3.1.2.3. Company of a Member State

**Definition**

Art. 2(1) of the Parent-Subsidiary Directive defines what is meant by the term “company of a Member State”, i.e. which entities come under the scope of application of the directive. The entity must be a company that

- takes one of the forms listed in the Annex to the Parent-Subsidiary Directive;
- is considered to be a resident of a Member State for tax purposes according to the national laws of that state and is not considered to be a resident for tax purposes outside the European Union under the terms of a tax treaty with a non-Member State; and
- is subject to one of the taxes listed in the Parent-Subsidiary Directive or to any other tax that may be substituted for any of the expressly mentioned taxes, without the possibility of an option or of being exempt.
All three criteria mentioned must be met simultaneously; however, it is sufficient that each of the criteria is met in one Member State. It is not required that all the criteria are met in one Member State. [663]

**Entity form**

Private and public companies limited by shares of different Member States typically come under the scope of application of the Parent-Subsidiary Directive. [664] European Companies (Societas Europaea – SE) and European Cooperative Societies (SCE) also come under the scope of the directive. [665] Otherwise, it depends on the Member State concerned which entity forms are covered.

In the case of some Member States, the Annex to the Parent-Subsidiary Directive expressly includes a list of all the national entity forms covered. This list is exhaustive. [666] For example, the list may include national cooperative society forms of some Member States, but not of all Member States. [667] National partnership forms are usually not included in the list and in most situations these would fall outside the scope of the directive because they are not separately taxable entities.

Some Member States have not included an express list of all possible national entity forms in the Annex to the directive but they have determined broadly that all national company forms incorporated under the law of the state concerned come under the scope of the directive provided that the other two criteria set forth in Art. 2 of the Parent-Subsidiary Directive are met. This type of a broad formulation is practical because it is less probable that this formulation leads to a treatment in conflict with the freedom of establishment principle than the formulation including a list of the different national entity forms covered. It is possible that an express list of national entity forms excludes an entity, which is to the extent similar to the entity forms covered, that the entity must be subject to the tax benefits similar to the benefits of the Parent-Subsidiary Directive in order for its tax treatment not to be in conflict with the freedom of establishment principle. [668] However, a broad and general determination of the entities covered may be problematic in the way that it may lead to a conflict if the state of residence of the subsidiary and the state of residence of the parent company interpret the term “company” differently. [669]

**Tax liability**

Even if a company would take one of the entity forms covered by the Parent-Subsidiary Directive it comes under the scope of the directive only if it is subject to one of the taxes listed in the directive (or to any other tax that may be substituted for any of the expressly mentioned taxes) without the possibility of an option or of being exempt. Tax-exempt entities do not come under the scope of the directive even if they would take a form covered by the directive. Entities that can choose whether to be treated as an exempt entity or not also fall outside of the scope of the directive.

Different partnership forms that are not treated as separately taxable entities also fall outside of the scope of the Parent-Subsidiary Directive. However, hybrid entity forms that are treated as a separately taxable entity in one Member State but as a transparent entity in another Member State may come under the scope of the directive.

The Parent-Subsidiary Directive does not set any limit for the required tax but companies established in low-tax states also come under the scope of the directive. It is somewhat unclear, however, as to what extent partially tax-exempt entities come under the scope of application of the directive. [670]

**Tax residence**

The application of the Parent-Subsidiary Directive requires that the tax residence of the company is in a Member State according to the tax laws of that state. For example, dividends paid to the Chanel Islands, therefore, do not come under the scope of the directive. [671]

The tax residence of the company must not be outside the European Union according to a tax treaty concluded with a non-Member State. Such a dual-residence conflict situation may emerge, for example, if the place of management of a company established and registered under the laws of a Member State is situated in a non-Member State that treats the company as a tax resident because of the place of management. This type of dual-residence company is left outside the scope of the directive for anti-avoidance reasons.

Dual-resident companies with their tax residence in two different EU Member States come under the scope of the directive even if there would be a tax treaty between the two states concerned. Also, dual-resident companies with their tax residence in a Member State and in a non-Member State come under the scope of the directive if there is no tax treaty between the states concerned. These types of dual-residence companies are not problematic for anti-avoidance reasons because there is no tax treaty that would prevent an EU Member State from taxing the profits of the company.

From the tax treatment perspective, the scope of application of the Parent-Subsidiary Directive also covers dual-resident companies that have their state of residence in one of the EU Member States and in a non-member tax treaty state if the tax treaty resolves the dual-residence conflict in favour of the EU Member State. This type of a
conflict may emerge, if the place of management of the company is in the EU Member State and the company is established and registered under the law of the other state. In such a situation, the company, however, falls outside of the scope of application of the Parent-Subsidiary Directive because the foreign entity form is not covered by the directive.

3.1.2.4. Permanent establishment

Definition

Art. 2(2) of the Parent-Subsidiary Directive defines the term “permanent establishment” for the purposes of the directive. The term “permanent establishment” means a fixed place of business situated in a Member State through which the business of a company of another Member State is wholly or partly carried on. The fixed place of business constitutes a permanent establishment for the purposes of the directive, however, only insofar as the profits of the place of business are subject to tax in the Member State in which it is situated by virtue of a tax treaty or, in the absence of a treaty, by virtue of national law.

In order for a fixed place of business to come under the scope of application of the directive, the place must meet similar requirements that apply to companies. The fixed place of business must be a permanent establishment of an EU resident company, it must be situated in a Member State and it must be subject to tax in the Member State in which it is situated.

Relation to the OECD Model Convention

The definition of the term “permanent establishment” included in the Parent-Subsidiary Directive corresponds to the basic definition of the same term in Art. 5(1) of the OECD Model Tax Convention. The definition of the Parent-Subsidiary Directive, unlike the OECD Model, however, requires that the permanent establishment is subject to taxes in the state in which it is situated. This additional requirement can be explained by the fact that the directive also covers companies only insofar as they are subject to taxes. Tax-exempt entities do not come under the scope of application of the directive.

The directive, however, does not set any minimum level on the required tax. It is sufficient that the permanent establishment in principle is subject to tax in the state in which it is situated, even though in practice no taxes would be paid for example because of a loss year or because of another reason.

It is sufficient that the taxing right of the permanent establishment state is not restricted by a tax treaty and that the state under its domestic law allocates dividend income to the permanent establishment. The holding on the basis of which the dividend is paid must form part of the business assets of the permanent establishment both for domestic tax law and in the case of tax treaty states for tax treaty purposes. [672]

3.1.2.5. Parent and subsidiary company

Companies of different Member States

Art. 3(1) of the Parent-Subsidiary Directive defines when a company that comes under the scope of application of the Directive qualifies as a parent company or as a subsidiary for the purposes of the directive. According to the article, the status of a parent company is attributed at least to any company of a Member State that comes under the scope of the directive and which has a minimum holding of 10% in the capital of such a company of another Member State that comes under the scope of the directive. A subsidiary is then the company the capital of which includes the holding of the parent company. Only direct holdings qualify. Indirect holdings are not taken into account when determining the 10% limit. The concept “holding in capital” also excludes mere holdings of shares in usufruct. [673] The holding situation on the day of the profit distribution is decisive.

The directive sets only the minimum requirement. The Member States are free to grant tax benefits similar to the benefits based on the directive in situations in which the holding is less than 10%.

Companies of the same Member State

A company of a Member State that has a minimum holding of 10% in the capital of a company of the same Member State qualifies as a parent company for the purposes of the Directive, provided that the holding is held in whole or in part by a permanent establishment of the first company situated in another Member State. [674] A subsidiary is then the company, the capital of which includes the holding. A parent company and a subsidiary company of the same Member State come under the scope of the directive only if the shares in the subsidiary belong to the assets of a permanent establishment situated in another Member State.

The directive also sets only the minimum requirement in respect of these situations. The Member States are also free to grant tax benefits similar to the benefits based on the directive in situations in which the holding is less than 10%.
Capital or voting rights

The Member States are free to replace the criterion of a holding in the capital by that of a holding of voting rights by means of bilateral agreements. [675]

Two-year holding period

Art. 3(2) of the Parent-Subsidiary Directive includes an option for the Member States to deny the directive benefits in certain anti-avoidance situations. Member States have the option of not applying the directive to companies of that Member State that do not maintain the required holding for an uninterrupted period of at least 2 years or to companies in which a company of another Member State does not maintain the required holding for an uninterrupted period of at least 2 years. [676]

The Member States may require under their national laws that the required holding exists for a certain time period, which must not exceed 2 years. The time period required may be different in the case of parent companies and in the case of subsidiaries.

Even if a holding period requirement is included in the domestic law of a Member State it cannot be required that the time has already elapsed before the profit distribution took place. The time period requirement may also be met after the distribution. However, it is acceptable to first tax the distribution at the time of the distribution, if the holding requirement is then not yet met, and then afterwards to reimburse the tax. [677]

3.1.2.6. Profit distribution

Broad concept

It is clear that the Parent-Subsidiary Directive applies only in the case of intragroup profit distributions. The directive, however, does not include a definition of the term “profit distribution”. There is a general understanding according to which the term “profit distribution” is a somewhat broader term than the term “dividend”. For example, the Parent-Subsidiary Directive covers disguised or hidden dividend distributions. Also, a return on hybrid instruments may be considered to come under the scope of the directive if the return is classified as dividend for national tax law purposes and if the payer and the recipient are companies that qualify as companies that come under the scope of the directive. [678]

Capital gains

The term “profit distribution” does not cover capital gains from the sale or other alienation of the shares. The Member States are free to choose whether or not to tax capital gains of the parent company received from the sale of the subsidiary shares. Several Member States, however, have broadened their domestic law participation tax exemption to cover capital gains received by the parent company from the sale of its subsidiary shares in addition to dividends received by a parent company from its subsidiary.

Liquidation distributions

Concerning the tax treatment in the state of residence of the income recipient, Art. 4 of the Parent-Subsidiary Directive expressly excludes liquidation distributions paid to the parent company when the subsidiary is liquidated. It seems, therefore, that the directive covers all situations in which the parent company or its permanent establishment receives a profit distribution from the subsidiary because of the shareholding relationship except the situation in which the subsidiary is liquidated. However, Art. 5 of the Parent-Subsidiary Directive (concerning the tax treatment in the state of residence of the subsidiary) does not expressly exclude liquidation distributions. Therefore, it is not completely clear whether the state of residence of the subsidiary must refrain from taxing liquidation distributions because of the directive. [679] The EU Court, however, has confirmed that the liquidation distributions excluded from the scope of Art. 4 do not cover liquidation distributions made in connection with a dissolution of a company in the context of a merger by acquisition. [680]

3.1.2.7. Other requirements

Primary rule

The Parent-Subsidiary Directive determines exclusively the requirements that the Member States may include in their domestic law as requirements for the directive benefits to be available. For example, Member States must not require that a company conducts business in order for the directive benefits to be available. The type of the activities of the company is irrelevant as regards the application of the Parent-Subsidiary Directive.

Avoidance

Tax benefits based on the Parent-Subsidiary Directive must be made available to companies that come under the scope of the directive except for clear tax-avoidance arrangements. [681] Normally, the moment of the dividend distribution is decisive when determining whether the distribution comes under the scope of the directive. If a
Member State applies a minimum holding period requirement, this requirement may also be met after the distribution moment. In tax-avoidance situations, a moment different from the moment when the distribution was made may be decisive.

### 3.1.2.8. EEA and other non-Member States

The **Parent-Subsidiary Directive** does not apply to profit distributions between non-EU-resident companies or permanent establishments outside the European Union and EU resident companies or permanent establishments in the European Union. The freedom of establishment principle included in the EEA Agreement, however, may require that similar benefits that apply in domestic situations are made available to situations including a profit distributing company, a distribution receiving company or a permanent establishment from an EEA State outside the European Union, provided that there is a comprehensive tax information exchange agreement between the states concerned. [682] A non-EU Member State may also apply tax principles similar to the benefits provided by the **Parent-Subsidiary Directive** based on a separate agreement. [683]

### 3.1.3. Tax treatment

#### 3.1.3.1. Tax treatment in the dividend recipient’s state

**3.1.3.1.1. Elimination of double taxation in the parent company state**

Arts. 4-6 of the **Parent-Subsidiary Directive** determine the tax treatment of a profit distribution that comes under the scope of application of the directive.

Art. 4 of the **Parent-Subsidiary Directive** requires that the state of residence of the parent company eliminates both international economic and juridical double taxation in the case of qualifying profit distributions. Juridical double taxation is already eliminated because the subsidiary state has no right to levy dividend withholding taxes but the elimination of economic double taxation is the task of the parent company. The Member States must not set any conditions that are not mentioned in the directive for a taxpayer to benefit from the elimination of double taxation. [684]

Art. 6 of the **Parent-Subsidiary Directive** also requires that the state of residence of the parent company does not levy a withholding tax on the profits received by the parent company from its subsidiary.

**3.1.3.1.2. Exemption or credit in the parent company state or in the permanent establishment state**

**Exemption or credit**

According to Art. 4 of the **Parent-Subsidiary Directive**, the state of residence of the parent company, and the possible state in which a permanent establishment of the parent company is situated, must either exempt distributions that come under the scope of the directive or eliminate double taxation with the credit method.

Member States are free to choose between the exemption and the credit method until the corporate tax systems of the Member States are harmonized. In practice, the exemption method is more commonly applied among the Member States. It is also possible that because of bilateral tax treaties, for example, a Member State applies the credit method in relation to certain states and the exemption method in relation to others. Such a different treatment, however, must not result in treatment that is in conflict with the freedom of establishment and the free movement of capital principles of the **TFEU**. Because of the TFEU requirements, it is best to apply the same method under domestic law and under the tax treaties with all of the EU Member States. When the exemption method is used in domestic situations, a carry-forward of the credit in loss years may have to be made available if the credit method is applied in cross-border situations. [685]

**Indirect credit**

In the case of the credit method, the state of residence of the parent company may in principle tax the profit distribution in accordance with its national tax laws. The same possibility applies in the case of the state in which the permanent establishment is situated if the distribution is connected with the permanent establishment. The state of residence of the parent company and the state in which the permanent establishment is situated, however, must allow a deduction from its taxes corresponding to the part of the corporate tax paid by the direct subsidiary or any lower-tier subsidiary in relation to the profits distributed to the parent company or the permanent establishment. The state of residence of the parent company and the state in which the permanent establishment is situated must grant an indirect credit for the taxes paid by the subsidiaries, even though these are separate taxable entities from the parent company.
If the corporate tax in the state of residence of the subsidiary is higher than the dividend tax in the state of residence of the parent company or in the state in which the permanent establishment is situated, the state of residence must not levy any additional tax.

**Lower-tier subsidiaries**

In addition to the corporate taxes paid by the direct subsidiary, the corporate taxes paid by lower-tier subsidiaries must also be credited, provided that all the companies are companies that would qualify for the benefits of the directive and provided that the required subsidiary-parent company relationship exists between the subsidiaries concerned. Each of the subsidiaries must be a company that would qualify for the directive benefits and a 10% holding must exist between each tier.

The indirect holding of the parent company in its sub-subsidiary does not need to be at least 10%; it is sufficient that the parent holds 10% of the shares in the direct subsidiary and the direct subsidiary in turn holds at least 10% of the shares in the lower-tier subsidiary. The lower-tier subsidiary may also be a resident in the same state as the parent company. [686]

**Ceiling**

The credit does not need to exceed the corresponding tax due in the state of residence of the parent company. This ceiling means a normal credit that cannot lead to reimbursement to the parent company of the taxes paid by the subsidiary. The total of the taxes paid in the subsidiary state may not be credited in the state of residence of the parent company, for example, if the tax rate in the parent company state is lower than in the subsidiary state. [687]

**Carry-forward**

The Parent-Subsidiary Directive does not mention whether the corporate taxes levied in the subsidiary states that could not be credited in the parent company state, for example because of a loss year, should be creditable in future on the basis of a carry-forward system. Because of the silence of the directive, it seems that Member States are free to decide whether or not to allow a carry-forward. Based on the Haribo case, it is, however, in conflict with the free movement of capital principle not to allow a carry-forward of the credit in a loss year when the exemption method is applied in domestic situations and if there is a loss carry-forward possibility in the country concerned. [688]

**Permanent establishment state**

The application of the exemption method or the credit method also concerns the state in which the permanent establishment is situated if the profit distribution concerned is effectively connected with the permanent establishment that the parent company has in another Member State. A cross-border situation covered by the directive exists even if the subsidiary and the parent company would be residents in the same Member State if the permanent establishment is situated in another Member State.

The Member State in which the permanent establishment is situated must also take the Parent-Subsidiary Directive into account if the subsidiary and the parent company are from two different Member States and the permanent establishment is situated in a third Member State. Because of the freedom of establishment principle of the TFEU the permanent establishment must be subject to as beneficial tax treatment as applies to the resident companies of the permanent establishment state. [689]

3.1.3.2. Tax treatment in the subsidiary state

**3.1.3.2.1. No withholding tax**

**No tax**

Art. 5 of the Parent-Subsidiary Directive requires that the state of residence of the subsidiary refrains from levying withholding taxes on the profits that the subsidiary distributes to the parent company. The profit distribution must not be taxed in the subsidiary state but the distribution must be exempt from tax. It is, for example, not acceptable to first tax the distribution and then later allow a credit for or a repayment of the tax.

**Exception**

On the basis of EU Court judgments, the state of residence of the subsidiary may have the right to levy a withholding tax on a qualifying profit distribution only if the recipient of the distribution has the right to a dividend imputation credit. [696] The countries that do not apply a dividend imputation credit system must therefore never levy a dividend withholding tax on qualifying distributions.

**3.1.3.2.2. Withholding tax**
**Broad concept**

Art. 5 of the Parent-Subsidiary Directive prohibits expressly only withholding taxes; however, the term “withholding tax” as it is used in the directive has a very broad meaning. The term “withholding tax” is considered to cover any tax levied on the basis of a distribution of profits from a company (including, for example, inheritance or gift taxes), irrespective of the nature or the name of the tax. Any tax levied in the subsidiary state on income is a withholding tax on distributed profits if the chargeable event for the tax is the payment of dividends or of any other income from shares, if the taxable amount is the income from those shares and if the taxable person is the holder of the shares. Based on the recent judgments of the EU Court, it seems that in order for a tax to constitute a prohibited withholding tax, the tax subject, i.e. the taxpayer, must be the parent company and not the profit-distributing subsidiary.

**Exceptions**

Withholding tax levied on a dividend imputation credit is not considered to be a withholding tax on a qualifying profit distribution and the withholding tax may therefore be acceptable. The term “withholding tax” also excludes an advance payment or prepayment of corporation tax to the Member State of the subsidiary that is made in connection with a distribution of profits to its parent company. These types of payment related to the dividend imputation credit system are not withholding taxes prohibited by the Parent-Subsidiary Directive. Based on the joined cases C-338/08 and C-339/08 Ferrero, also a refund of the adjustment surtax or compensatory tax related to a dividend imputation system may fall outside the scope of the profit distributions that must be tax exempt under the Parent-Subsidiary Directive.

The Parent-Subsidiary Directive does not affect the application of domestic or agreement-based provisions designed to eliminate or lessen economic double taxation of dividends. Provisions relating to the payment of tax credits to the recipients of dividends are especially acceptable from the perspective of the directive.

In any case, the domestic tax treatment must not lead to a conflict with the basic freedoms of the TFEU. Therefore, almost all EU Member States have abandoned the dividend imputation system and replaced it with some other system. Currently, Art. 7 of the directive, therefore, has only very limited relevance.

**3.1.4. Tax-avoidance situations**

**Anti-avoidance provision**

The tax benefits based on the Parent-Subsidiary Directive may be denied in the case of a tax-avoidance arrangement lacking economic reality. The Member States have the right to apply domestic or agreement-based provisions required for the prevention of fraud or abuse.

**Directive shopping**

The tax benefits based on the Parent-Subsidiary Directive do not need to be made available in the case of directive-shopping arrangements if the taxpayer does not show that there are business reasons other than tax avoidance for the arrangement. The directive benefits do not need to be made available if the parent company that is a resident in a Member State is not the beneficial owner of the profit distribution and the beneficial owner is not from a Member State.

**Proportionality**

The principle of proportionality must be followed when applying anti-avoidance provisions. A tax-avoidance norm and the way in which it is applied must be proportionate to the object of the provision. The norm must be suitable for its objective and it must not restrict the benefits based on EU law more than what is necessary. Anti-avoidance norms can be applied primarily in the case of totally artificial arrangements lacking non-tax motives.

**Burden of proof**

Taxpayers must always have the possibility to prove that there are business reasons other than tax avoidance for an arrangement. An anti-avoidance provision that is applied automatically to certain arrangements without hearing the taxpayer, therefore, cannot normally be in accordance with EU law.