

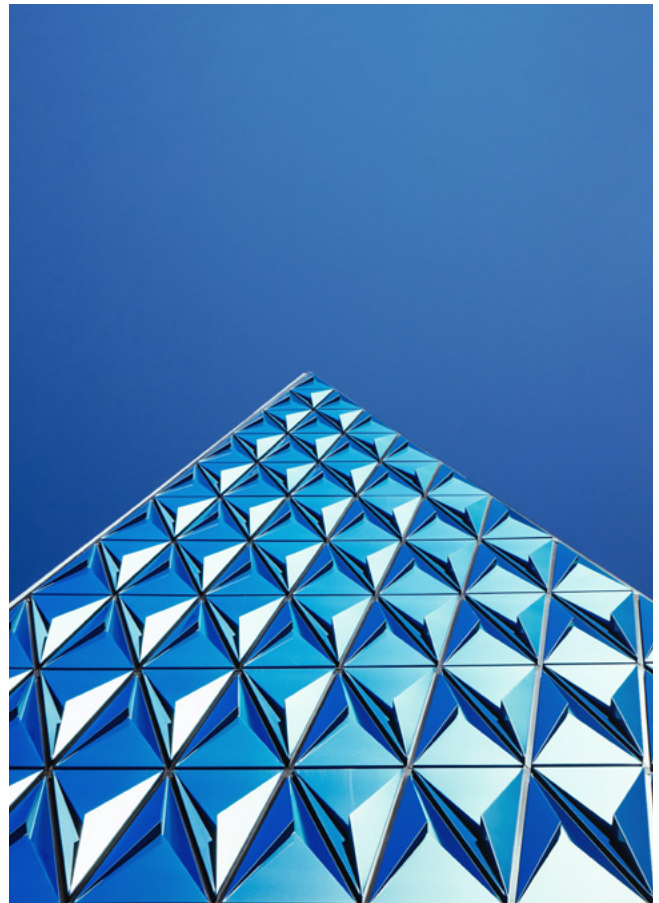
THE (LIMITED) EFFECT OF DIRECTIVES ON THE APPLICATION OF TAX TREATIES UNDER PUBLIC INTERNATIONAL LAW AND EUROPEAN UNION LAW

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1. INTRODUCTION

As of the amendment of the Parent-Subsidiary Directive in 2014, directives in the area of direct taxation may contain an obligation for the EU Member States to tax income. Such an obligation to tax income would be incompatible with obligations under tax treaties if such treaties contain an obligation to refrain from taxing that same income. In the event of such an incompatibility, the question arises as to which obligation must be given effect to by an EU Member State in practice: the directive's obligation to tax or the tax treaty's obligation to no tax.¹

In formulating an answer to this question, reference may be made to the rules of public international law, domestic law, and European Union law.² In this article, the conclusions, based on the analysis set out in the book 'The Effect of Directives in the Area of Direct Taxation on the Interpretation and Application of Tax Treaties', regarding the question which obligation must be given effect to by an EU Member State under the rules of public international law (section 2) and European Union law (section 3) are set out.³ In that respect, the focus is on setting out the conclusions regarding the question whether a directive is able to render an incompatible tax treaty inapplicable under



public international law or the laws of the European Union. This article ends with a conclusion (section 4).

2. PUBLIC INTERNATIONAL LAW

For the purposes of determining the effect of directives on the application, in terms of applicability, of tax treaties concluded by the EU Member States, a distinction must be drawn between tax treaties concluded by an EU Member State with another EU Member State ("Intra-EU Treaties") and tax treaties concluded with a third state ("Extra-EU Treaties"). The reason for drawing this distinction is that, under the conflict rules of public international law, a directive may only take precedence over a tax treaty that has been concluded between parties that have expressed, directly or indirectly, their consent to be bound by that directive. As third states have not expressed their consent to be bound by (article 288 of) the TFEU or the adoption of a directive within the Council, directives should, in accordance with the principle of *pacta tertiis*, not be able to affect the application of Extra-EU Treaties.⁴



As a consequence, EU Member States are required to give effect to an Extra-EU Treaty that would be incompatible with a directive under public international law.⁵

Whereas a directive would not be able to affect the application of Extra-EU Treaties under the general conflict rules of public international law, this is different for Intra-EU Treaties. As the EU Member States have expressed their consent to be bound by a directive, either directly by voting in favour of its adoption or indirectly by entering into the TFEU, it is conceivable that the general conflict rules of public international law could result in the application of tax treaties concluded between them being affected by the directive as a decision of an international organization.⁶ Under the codified general conflict rule of public international law, i.e., the *lex posterior* conflict rule of article 30 Vienna Convention 1969, this is conceivable if the adoption of a directive is regarded as relevantly similar to the conclusion of an Intra-EU Treaty.⁷ If relevantly similar, it is arguable that the *lex posterior* conflict rule of article 30 Vienna Convention 1969 may be applied (by analogy) to a conflict between a directive and an Intra-EU Treaty. If applicable (by analogy), a directive sets

aside an incompatible Intra-EU Treaty if (i) the directive has been adopted after the conclusion of the incompatible Intra-EU Treaty and (ii) the subject matter of the directive is the same as that of the earlier, incompatible Intra-EU Treaty. Whereas it might seem straightforward to determine whether the directive is later as compared to the Intra-EU Treaty, it is less so the case with respect to the sameness of their subject matter; the sameness of subject matter requires an assessment of the topic or substance dealt with by the directive and the incompatible Intra-EU Treaty on an overall basis. Based on an assessment of the topic of the directives adopted up to and including 30 October 2022,⁸ it is considered arguable that such directives relate to the same subject matter as Intra-EU Treaties based on their similarities with Intra-EU Treaties in terms of topics or substance dealt with. There are, however, also differences in topics or substance dealt with that would make it arguable that they do not relate to the same subject matter. Hence, the sameness of subject matter is not a given.⁹ Consequently, it is only arguable – and not a given – that a

later directive takes precedence over an earlier Intra-EU Treaty on the basis of an (analogous application of) the *lex posterior* conflict rule of public international law.

In addition to the codified general conflict rule of public international law, reference may also be made to the *lex specialis* conflict rule that, although not codified, is considered a widely accepted conflict resolution rule under public international law.¹⁰ Pursuant to this conflict rule, a directive, as a decision of an international organization, would render an Intra-EU Treaty inapplicable if the directive provision that is incompatible with (a) provision(s) of an Intra-EU Treaty relates to the same subject matter as that (those) provision(s) and in a way that is more precise.¹¹ In order to apply the *lex specialis* conflict rule, a sameness of subject matter test applies at provision-level (instead of an overall-level for the purposes of the *lex posterior* conflict rule). Based on the partial overlap in subject matter dealt with directives and Intra-EU Treaties in general and the understanding that directives generally have a more limited scope, it would seem that the *lex specialis* conflict rule is capable of resulting in a directive (provision) setting aside incompatible Intra-EU Treaty provision(s) in the event of a conflict. With respect to this conclusion two caveats must be made to not overstate its importance. First, it should be acknowledged that the *lex specialis* conflict rule, although having been applied to conflicts between different, yet equally ranked, sources of public international law, has not yet been applied to a conflict between a decision of an international organization and a treaty.¹² Second, the applicability of the *lex specialis* conflict rule depends on assessment of the subject matter dealt with by the relevant directive provision and the subject matter dealt with by the incompatible provision(s) of an Intra-EU Treaty. Hence, its effect may vary from one conflict



to another. As such, it is merely arguable – and not a given – that a directive provision is capable of setting aside an incompatible provision of an Intra-EU Treaty on the basis of the *lex specialis* conflict rule.

3. EUROPEAN UNION LAW

For the purposes of determining whether a directive is able to render an incompatible tax treaty inapplicable under European Union law, the starting point is that a directive enjoys primacy vis-à-vis such a tax treaty. Based on such primacy, national courts are, in principle, required to set aside provisions of tax treaties that are incompatible with provisions of a directive.¹⁴



Whereas this primacy-based conflict rule might seem to indicate that tax treaties must be rendered inapplicable to the extent incompatible with directives, the following caveats must be made. First, the primacy-based conflict rule does not apply with respect to those Extra-EU Treaties that have been concluded by an EU Member State before its accession to the European Union if that setting aside entails that rights of, or obligations towards, third states would be affected (see article 351 TFEU (as interpreted by the Court of Justice of the European Union in *Generalstaatsanwalt München*)¹⁵).¹⁶ Second, if applicable to a conflict between a directive and a tax treaty, the primacy-based conflict rule must also be 'enforceable' or 'reliable'. In order for the primacy-based conflict rule to be 'enforceable', it must be established that the directive provision that is incompatible with the provision(s) of a tax treaty has direct effect and that the setting aside of the tax treaty's provision(s) does not result in the imposition of an (additional)

obligation for the taxpayer (prohibition of reverse vertical direct effect).¹⁷ Within the context of conflicts between directives that impose an obligation to tax income and tax treaties that impose a duty to not tax income, the prohibition of reverse vertical direct is highly relevant because the setting aside of a provision that prevents taxation of income in order to tax that income would result in a higher tax burden. If the setting aside results in a higher tax burden, the primacy of a directive would not be 'enforceable' before a national court in the sense that such a court is not required, as a matter of EU law, to set aside the incompatible tax treaty. As such, the primacy of a directive vis-à-vis a tax treaty does not in and of itself entail that each and every tax treaty that is incompatible with such a directive must be set aside by a national court. Such primacy is, essentially, a one-way street¹⁸ that may only result in the setting aside of tax treaties if that would be beneficial for a taxpayer; if and to the extent that the tax treaty provides for a lower tax burden than would be the case if set aside by a directive, the directive's primacy is not enforceable as a result of the prohibition of reverse direct effect.¹⁹

4. CONCLUSION

With respect to the question whether a directive is able to render an incompatible tax treaty inapplicable under public international law or the laws of the European Union, the following may be concluded. First, under public international law, directives may only be able to render tax treaties between EU Member States inapplicable on the basis of the *lex posterior* and *lex specialis* conflict rules; tax treaties with third states may not be affected. Second, under public international law, the extent to which a directive may be able to set aside a tax treaty between two member states requires an assessment of the timing of the adoption of the directive vis-à-vis the conclusion of the relevant tax treaty and a comparison of subject matter on an overall level (*lex posterior*) or a comparison of subject matter on a provision-level (*lex specialis*). Depending on the outcome of such an assessment, a directive can render a tax treaty between EU Member States inapplicable under

public international law. Third, under the laws of the EU, the primacy of a directive obliges a national court to, in principle, render inapplicable incompatible tax treaties concluded by the EU Member States, unless this would result in the rights of, or obligations towards, third states under pre-accession tax treaties with third states being affected. Fourth, the obligation to render such tax treaties inapplicable needs to be enforceable. In order to be enforceable, a directive provision that is incompatible with a tax treaty needs to have direct effect while the setting aside of the tax treaty may not result in the imposition of a higher tax burden due to the prohibition of reverse vertical direct effect. Within the context of a conflict between a directive that requires taxation of income and a tax treaty that requires non-taxation of that same income, the prohibition of reverse vertical direct effect effectively entails that the tax treaty cannot be set aside on the basis of the primacy-based conflict rule of the laws of the EU. As such, a directive that is aimed at increasing

the tax burden of a taxpayer may enjoy primacy vis-à-vis an incompatible tax treaty, but such primacy would, in fact, not be enforceable and would not be able to render inapplicable such a tax treaty in practice.



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¹ For more background, see T.M. Vergouwen, *The Effect of Directives in the Area of Direct Taxation on the Interpretation and Application of Tax Treaties*, Kluwer Law International 2023, para. 1.2.

² Regarding the interaction between the three perspectives, see T.M. Vergouwen, *The Effect of Directives in the Area of Direct Taxation on the Interpretation and Application of Tax Treaties*, Kluwer Law International 2023, para. 1.4.

³ T.M. Vergouwen, *The Effect of Directives in the Area of Direct Taxation on the Interpretation and Application of Tax Treaties*, Kluwer Law International 2023.

⁴ In this respect, it is noted that there are Extra-EU Treaties that contain subordination clauses that provide that the obligations of EU Member States would not be affected by the relevant Extra-EU Treaty. If such a subordination clause is included in an Extra-EU Treaty, this entails that a directive would be able to affect the application of the relevant Extra-EU Treaty in such a way that it is inapplicable under public international law. If the Extra-EU Treaty would be inapplicable under public international law, the EU Member State concerned would no longer face conflicting obligations and should only comply with the obligations arising from the directive. See, to this effect, T.M. Vergouwen, *The Effect of Directives in the Area of Direct Taxation on the Interpretation and Application of Tax Treaties*, Kluwer Law International 2023, para. 6.4.2.3 and 6.4.5.

⁵ For more background, see T.M. Vergouwen, *The Effect of Directives in the Area of Direct Taxation on the Interpretation and Application of Tax Treaties*, Kluwer Law International 2023, para. 6.2, 6.3, 6.4.2.3.4 and 6.5.

⁶ Regarding this characterization of a directive, see T.M. Vergouwen, *The Effect of Directives in the Area of Direct Taxation on the Interpretation and Application of Tax Treaties*, Kluwer Law International 2023, chapter 2.

⁷ Regarding the need for an analogous application of the *lex posterior* conflict rule of article 30 Vienna Convention 1969, see T.M. Vergouwen, *The Effect of Directives in the Area of Direct Taxation on the Interpretation and Application of Tax Treaties*, Kluwer Law International 2023, para. 6.4.2.2.1.

⁸ See T.M. Vergouwen, *The Effect of Directives in the Area of Direct Taxation on the Interpretation and Application of Tax Treaties*, Kluwer Law International 2023, para. 6.4.2.2.4 for this assessment.

⁹ See T.M. Vergouwen, *The Effect of Directives in the Area of Direct Taxation on the Interpretation and Application of Tax Treaties*, Kluwer Law International 2023, para. 6.4.2.2.4.ix.

¹⁰ See, to this effect, *inter alia*, ILC, 2006, *Fragmentation of International Law: Difficulties arising from the diversification and expansion of international law*, Report of the Study Group of the International Law Commission (Finalized by Martti Koskenniemi), A/CN.4/L.6, p. 34, par. 56, I. Sinclair, *The Vienna Convention*

on the Law of Treaties, Manchester: Manchester University Press 1984, p. 396, P. Merkouris, Article 31(3)(c) of the VCLT and the Principle of Systemic Integration, London: Queen Mary University of London 2010, p. 131 and J. Finke, *Regime-collisions: Tensions between treaties (and how to solve them)* in: *Research Handbook on the Law of Treaties* (C.J. Tams, A. Tzanakopoulos & A. Zimmermann), Cheltenham: Edward Elgar Publishing 2014, p. 422, P. Niemelä, *The Relationship of EU Law and Bilateral Investment Treaties of EU Member States: Treaty Conflict, Harmonious Coexistence and the Critique of Investment Arbitration*, 2017, p. 27 and Broekhuijsen, D.M., *A Multilateral Tax Treaty: Designing an Instrument to Modernise International Tax Law*, Alphen aan den Rijn: Kluwer Law International 2018, p. 174.

¹¹ See, to this effect, T.M. Vergouwen, *The Effect of Directives in the Area of Direct Taxation on the Interpretation and Application of Tax Treaties*, Kluwer Law International 2023, para. 6.4.3.

¹² See T.M. Vergouwen, *The Effect of Directives in the Area of Direct Taxation on the Interpretation and Application of Tax Treaties*, Kluwer Law International 2023, para. 6.4.3.6.

¹³ See T.M. Vergouwen, *The Effect of Directives in the Area of Direct Taxation on the Interpretation and Application of Tax Treaties*, Kluwer Law International 2023, para. 7.2.1 and case law referred to there.

¹⁴ For this obligation to set aside incompatible provisions in general, see, for example, Court of Justice of the European Union, 24 June 2019, Case C-573/19 (Poplawski), para. 58 and Court of Justice of the European Union, 18 January 2022, Case C-261/20 (Thelen Technopark Berlin), para. 30.

¹⁵ See Court of Justice of the European Union, 28 October 2022, Case C-435/22 PPU (Generalstaatsanwalt München).

¹⁶ See, regarding article 351 TFEU, T.M. Vergouwen, *The Effect of Directives in the Area of Direct Taxation on the Interpretation and Application of Tax Treaties*, Kluwer Law International 2023, para. 7.2.2.1.

¹⁷ Regarding the conditions for enforceability of the primacy-based conflict rule, see T.M. Vergouwen, *The Effect of Directives in the Area of Direct Taxation on the Interpretation and Application of Tax Treaties*, Kluwer Law International 2023, para. 7.3.

¹⁸ See G.W. Kofler, *Direct Applicability and Direct Effect in: Principles of Law: Function, Status and Impact in EU Tax Law* (C. Brokelind), Online: IBFD 2014, para. 12.2.3.

¹⁹ See T.M. Vergouwen, *The Effect of Directives in the Area of Direct Taxation on the Interpretation and Application of Tax Treaties*, Kluwer Law International 2023, para. 7.3.5.