Chapter 22

Hungary: Tax Competition Á La Hungary: Tax the Turnover and Relinquish the Income

Balázs Károlyi

Abstract

This chapter delves into the most recent issues of fiscal sovereignty regarding the Hungarian direct tax system. It highlights the actual and potential conflicts between domestic corporate tax rules (including not only corporate income tax provisions but also other types of special taxes) and primary and secondary EU law. In respect to clashes with primary EU law, this chapter explores the recent case law of the Court of Justice of the European Union in light of the fundamental freedoms and the EU Charter. Furthermore, regarding secondary EU law, this chapter considers the compatibility of domestic rules with the anti-avoidance directives as well as with the global minimum tax directive and argues that a proliferation of similar conflicts can be expected across the EU due to the peculiar nature and inherent mechanisms of the relevant directives.

Keywords: *tax sovereignty, fundamental freedoms, turnover taxes, global minimum tax, taxpayers' rights, EU law, transposition, tax avoidance, tax competition, corporate taxation*

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1. Introduction

The concept of the Economic Governance research project includes an introductory chapter that provides for an overview of the most important EU rules that are relevant for direct tax matters and highlights the recent trends in the jurisprudence of the CJEU from which the focal points of clash between EU law and national tax law can be inferred. Therefore, these general observations will not be repeated in this contribution. It will deal with country–specific issues.

Notably, the peculiar features of the Hungarian corporate tax system have fuelled many legal debates regarding the compatibility of national rules with EU law, and most of the recent trends in direct tax-related case law are reflected in Hungarian cases as well. Indeed, several cases on the compatibility of turnover-based business taxes with the fundamental freedoms and State aid rules and the potential violation of taxpayers' rights and that of the Charter of the Fundamental Rights of the European Union ('Charter') have a Hungarian origin. Although the Hungarian corporate income tax system is very competitive, with a very low general tax rate of 9% and numerous tax base narrowing items, it is complemented in many sectors with special corporate taxes (which notably include extra-profit taxes) that are often levied on turnover instead of profit and are often designed with a progressive tax rate structure. The contested provisions of the Hungarian corporate tax system are to a large extent attributable to these special corporation taxes. Therefore, it is important to involve them in the analysis and not to limit the focus on corporate income taxation in the strict sense as national corporate taxation consists of many other type of relevant taxes.

Following the introduction (Section 1), this contribution continues by addressing recent cases dealing with the compatibility of Hungarian corporate tax rules with primary EU law (Section 2). As pointed out in the preceding paragraph, this topic is also related to the question of State aid compatibility, however, it is a central issue for another chapter of the present book. Therefore, in order to avoid overlaps, it will not be dealt with separately in this chapter. Thus, the primary law conformity practically means conformity with the fundamental freedoms (Section 2.1.) and the Charter (Section 2.2.) for the purposes of this contribution. Within the fundamental freedoms subsection, the core part revolves around the compatibility of turnover–based business taxes because the CJEU had to rule on several occasions on that and it played an important role both in academic discussions and in shaping national tax systems (Section 2.1.1.). Another subsection deals with a more classic issue and examines the compatibility of a registration requirement and an extremely severe corresponding penalty with the fundamental freedoms (Section 2.1.2.). Regarding the potential violation of the Charter, the Hungarian case (Marcas MC) primarily deals with the scope of application of the Charter rather than the substantive provisions of the Charter themselves (Section 2.2.). Following the examination of consistency of the national corporation system with primary EU law, the next section deals with their recent or potential conflicts with secondary EU law (Section 3.). Recently two major harmonization occurred in the field of substantive corporate taxation, namely the adoption of the ATA Directives and the GloBE Directive. As the former became effective only recently, while the latter is not yet applicable, this subsection attempts to highlight future issues as none of the conflicting matters have reached the CJEU yet. Eventually, some concluding remarks will be made (Section 4.).

2. Compatibility of Hungarian corporate tax rules with primary EU law

2.1. Compatibility with the fundamental freedoms

2.1.1. Progressive turnover-based business taxes in light of the fundamental freedoms

2.1.1.1. The *Hervis* case

In several instances, the CJEU has been asked to address the compatibility of progressive turnover-based business taxes with fundamental freedoms. First, it had to address the issue in the *Hervis* case[1] concerning the application of the Hungarian store retail trade tax. The basis of assessment of the tax was the net turnover derived by the taxpayer from retail trade and depending on the level of turnover, various tax rates were applied (0%–0.1%–0.4%–2.5%), gradually. The Austrian SPAR group had two Hungarian subsidiaries, SPAR and Hervis, engaged in grocery and sports retail shop operations, respectively. The store retail trade tax also contained a consolidation rule, pursuant to which the applicable tax rate to the revenue of Hervis was calculated on the basis of the aggregated Hungarian turnover of the whole group, including the SPAR shops that were not even present in the sport retail market. Thus, because of the progressive tax rate structure, Hervis was subject to a higher average tax rate than in a situation where it had been calculated solely on its own turnover. At the same time, its direct competitors' average tax rate was calculated on the basis of their own individual turnover as the consolidation rule was not applicable in their case. Owing to this specific situation, the CJEU examined the compatibility of a progressive tax rate structure of the turnover-based tax together with a consolidation rule applicable to group companies. Consequently, the CJEU held that group companies were disadvantaged due to the combination of two factors: (i) an obligation to aggregate the turnover of group member companies operating in the Hungarian store retail trade sector;

1 CJEU, 5 February 2014, C-385/12*, Hervis Sport- és Divatkereskedelmi Kft.*, ECLI:EU:C:2014:47.

and (ii) steeply progressive tax rates, which had to be calculated based on this aggregated turnover.

The CJEU left it to the referring national court to verify whether the above-mentioned disadvantage resulted in indirect discrimination; that is, whether taxable persons falling into the highest tax band were, in the majority of cases, group members held by foreign parent companies.[2]

As the consolidation rule played an important role in deciding the *Hervis* case, the question of whether progressive turnover taxes violate the fundamental freedoms in themselves, remained unanswered. This more generic issue emerged in the *Vodafone* and *Tesco* cases, in which the consolidation rule of the special taxes (store retail trade tax and telecommunications tax) was not applicable.

2.1.1.2. Advocate General Kokott's interpretation of the indirect discrimination concept in the context of progressive turnover-based taxes

In the framework of turnover-based progressive taxes, the core issue revolves around the nature and extent of the connection that must exist between a seemingly neutral criterion of differentiation (i.e. the level of turnover) and the prohibited criterion of differentiation (i.e. the nationality of the legal entities)[3] to establish the existence of indirect discrimination.[4] As long as high-turnover enterprises are mainly foreign-owned and low-turnover enterprises tend to have domestic ownership, the question can be raised as to whether this differentiation under turnover-based taxes would constitute indirect discrimination against foreign-owned companies in breach of the freedom of establishment.[5]

As mentioned above, in the *Hervis* case, the Court embraced a broad concept of indirect discrimination. It sufficed that in the 'majority of cases', the disadvantaged group of taxable persons suffering from the highest tax band and thus from the highest average tax rate comprised foreign–owned companies. In addition, there was no requirement other than this majority rule. Therefore, even a totally incidental and factual correlation between the distinguishing criterion and the location of companies' seats may be sufficient to establish indirect discrimination.

2 C-385/12, paras. 32–39.

3 More specifically, regarding the location of the seat of parent companies, foreign ownership is also a prohibited criterion because the fundamental freedoms do not strictly protect foreign nationals but, more generally, all cross-border economic situations, encompassing cases where the foreign parent company exercises its freedom of establishment in the host country by way of incorporating domestic subsidiaries. See: CJEU, 1 April 2014, C-80/12, *Felixstowe Dock and Railway Company and Others*, ECLI:EU:C:2014:200, para. 23.

4 The question of indirect discrimination in the context of turnover-based business taxes is also scrutinized in detail in: Szudoczky and Károlyi, 2020b.

5 Provided that the foreign parent is incorporated in another Member State, as non-EU entities can only invoke provisions on the free movement of capital and not the freedom of establishment.

In the *Vodafone* and *Tesco* cases,[6] Advocate General Kokott suggested – similar to some scholars[7] – that the scope of indirect discrimination should be narrowed.[8] In particular, she distinguished between qualitative and quantitative criteria with respect to the extent and nature of the correlation between the distinguishing criterion (i.e. turnover) and the protected criterion (i.e. seat/ownership of undertakings).

Regarding the quantitative criterion, she confirmed her previous position that the correlation should be identifiable in most cases.[9] However, the new element in her reasoning was that a purely quantitative approach should not be sufficient and, therefore, a qualitative criterion must also be taken into consideration; the distinguishing criterion must intrinsically or typically affect foreign companies and a merely incidental link should not suffice.[10] The purpose of the qualitative criterion is to exclude merely incidental quantitative correlations. She interprets an intrinsic connection to the distinguishing criterion as one that 'clearly suggests the likelihood of the correlation in the vast majority of the cases'.[11] In the *Vodafone* and *Tesco* cases, this test boiled down to the question of whether the high level of turnover correlates intrinsically with foreign-owned companies. She was of the opinion that, although it is more likely that high-turnover companies will tend to be multinationals and thus operate across borders than companies with lower turnover, there is no clear reason to conclude that foreign companies will generate higher turnovers within the territory of a certain country than domestic companies.[12]

Furthermore, the Advocate General opined that the intention of the legislature to discriminate could also play a role in the indirect discrimination test as an alternative, second prong of the qualitative test. In this sense, evidence that the legislature intended to discriminate against foreign-owned companies may fulfil the qualitative test, even in the absence of an intrinsic correlation.[13] Based on this prong, legal relevance should be assigned to the fact that the legislature intentionally chose the distinguishing criterion to disadvantage foreign-owned undertakings and that this effect was quantitatively measurable.[14] This stems from the purpose of the qualitative criterion: if the legislature specifically intends to disadvantage foreign-owned companies, then the correlation can no longer be regarded as incidental. According to the Advocate General, this requirement can also be inferred from the principle of the prohibition of the abuse of rights – Member States cannot exploit special market situations or choose particular distinguishing criteria to shift the tax burden

6 Her opinions are basically identical in the two cases; however, her opinion in the *Vodafone* case is more elaborate and, therefore, reference will be made to her statements there.

7 Mason and Parada, 2019.

8 For a detailed description and analysis of the Advocate General's opinions, see: Szudoczky and Károlyi, 2020a, pp. 22–26.

9 Opinion Advocate General Kokott, C-75/18, *Vodafone Magyarország*, para. 63.

10 Opinion Advocate General Kokott, C-75/18, para. 74.

11 Opinion Advocate General Kokott, C-75/18, para. 78.

12 Opinion Advocate General Kokott, C-75/18, paras. 79–81.

13 Opinion Advocate General Kokott, C-75/18, para. 84.

14 Opinion Advocate General Kokott, C-75/18, paras. 83–85.

on foreign-owned taxpayers. However, she emphasised that the examination of the legislature's intentions must be based on a strict, objective test: there must be clear evidence that disadvantaging foreign companies was the primary objective of the measure perceived and endorsed by Member States.[15] Ultimately, Advocate General Kokott did not find an intrinsic correlation between the level of turnover and foreign ownership of undertakings, nor did she find that the primary objective of the legislature was to tax foreign enterprises. Thus, she concluded that no indirect discrimination had occurred.

2.1.1.3. Decision of the Court in the *Vodafone* and *Tesco* cases

After excluding the existence of direct discrimination,[16] the Court examined whether the progressive rate structure of the tax brought about indirect discrimination. First, the Court turned to examining the impact of the tax (this can be regarded as the quantitative criterion in Advocate General Kokott's test) and referred to its previous case law, finding that the measure must disadvantage foreign-owned companies in most cases.[17] Within the framework of this quantitative scrutiny, the Court found in its *Vodafone* judgment concerning the telecommunications tax that in the lowest tax-exempt band, only domestically owned companies fell; in the intermediate band, the ratio of foreign and domestically owned companies was equal; and in the higher bands, taxpayers were predominantly owned by shareholders of other Member States.[18] In the *Tesco* case, regarding the store retail trade tax, it was established that the taxable persons that fell only within the exempted lowest tax band were all domestically–owned taxable persons, whereas those who fell within the third and fourth bands were predominantly foreign-owned taxable persons.[19] Thus, a greater proportion of tax revenue was collected from foreign-owned enterprises, which were also subject to a substantially higher effective tax rate.

However, in the next step, the Court recalled that Member States are free to design their tax systems, including the adoption of progressive taxation, even in the case of taxes in which the basis of assessment is turnover. This is because the level of turnover is a neutral criterion of differentiation and it also 'constitutes a relevant indicator of a taxable person's ability to pay'[20]. Here the Court also referred to the Preamble of contested special taxes according to which the objective of those taxes was to levy a tax on taxpayers whose ability to pay exceeded the general obligation to pay taxes.[21]

15 Opinion Advocate General Kokott, C-75/18, para. 92.
16 CJEU, 3 March 2020, C-75/18, *Vodafone Magyarország*, ECLI:EU:C:2020:139, para. 44.
17 C-75/18, para. 43.
18 C-75/18, paras. 47–48.
19 CJEU, 3 March 2020, C-323/18, *Tesco-Global Áruházak*, ECLI:EU:C:2020:140, para. 67.
20 C-75/18, paras. 49–51.
21 C-75/18, para. 51.

Reflecting to the outcome of the quantitative test, the Court stated that the fact that the greater part of the tax is paid by foreign-owned companies is not sufficient in itself to establish indirect discrimination as it is merely attributable to the market situation in Hungary where foreign-owned enterprises have a dominant position. Consequently, this outcome is a kind of matter of chance and would not be any different in the case of a proportional tax either.[22] Therefore, the Court concluded that the progressive rate structure did not create inherently any discrimination.[23]

2.1.1.4. Assessment of case law

Unfortunately, the *Vodafone* and *Tesco* judgments have left many questions open. This can be partly attributed to the very narrowly phrased question referred to the Court; specifically, the domestic court asked whether the fundamental freedoms precluded a national measure that caused the actual tax burden to fall on foreign-owned enterprises. As both the Court and Advocate General Kokott pointed out, had the answer been affirmative, practically all Hungarian taxes levied on businesses would conflict with the fundamental freedoms, as the local market is dominated by foreign-owned enterprises. The Court is certainly right when it states that Member States should be free to introduce business taxes even if the actual tax burden falls mainly on foreign-owned enterprises. It would have been interesting to observe the Court's approach to a question that stressed the disproportionate tax burden caused by the progressivity of taxes; in other words, it would have been interesting to see the Court's answer to the general query of whether the disproportionate differences in the tax burden, resulting from the progressive rate structure in the context of turnover taxes, appropriately track the ability to pay principle – the alleged aim of the contested business taxes.

The judgments have not unclouded the uncertainties pertaining to the indirect discrimination test either. Regarding the quantitative test, the Court referred to its previous case law and required the unfavourable treatment of the cross-border situation in most cases; however, it did not specify what exactly was meant by the term 'most cases'. In the *Vodafone* and *Tesco* cases, this condition was tacitly met as the Court moved forward to examine the relevant market situations. The verification of the quantitative test was insufficient to establish indirect discrimination.

Although the empirical evidence that the taxes at issue burdened foreign–owned undertakings in most of the cases did not eventually turn out to be conclusive, it is still questionable whether the Court has embraced the qualitative test put forward by Advocate General Kokott. It certainly required something more than the fulfilment of a pure quantitative criterion and stated that unfavourable treatment should not be fortuitous – not a matter of chance. Although it also used the terminology of inherent discrimination, a key concept of Advocate General Kokott's test, it did not explicitly

22 C-75/18, para. 52.
23 C-75/18, para. 54.

refer to her opinion in this regard and only addressed this issue very briefly and exclusively within the narrow scope of the referred questions. The second prong of Advocate General Kokott's qualitative test – namely, the scrutiny of the intention of the legislator – was beyond the scope of the judgments. In my view, this is not a problem if the intention of the legislator is eliminated from the test, as it can seriously jeopardise legal certainty.[24] It is practically impossible to attribute intentions to a legislative body comprised of many individuals with different political views and intentions, and an indirect discrimination test should be based on objective criteria.

2.1.1.5. Hervis overturned?

It is obvious that a stricter standard was needed than mere majority rule – which was seemingly applied in *Hervis* – as the burden of a certain tax that falls mainly on foreign-owned economic operators should not amount to indirect discrimination in itself. In the academic literature, the *Tesco* and *Vodafone* judgments were assessed as superseding the *Hervis* ruling, where only a mere quantitative test was explicitly applied.[25]

There is, however, a possible reconciliation of *Hervis* with the two more recent judgments. As mentioned previously, *Hervis* was based on a specific fact pattern because the consolidation rule was also applicable. It allows for an interpretation that the qualitative test – the requirement of inherent discrimination to exist – was tacitly also included in the judgment. One can argue that there is an inherent correlation between the high level of turnover and multinationals (i.e. groups with foreign ownership) because these group companies are the ones that tend to engage in cross-border economic activity, while domestic companies that conduct business only in their own countries typically do not operate in a group structure. Instead, they conduct business as standalone companies or contractors of a franchise system. Such a typical correlation between high turnover and foreign ownership/group structure was not denied in the *Vodafone* and *Tesco* cases by Advocate General Kokott, who stated that 'high–turnover undertakings tend to operate across national borders within the internal market and there may therefore be a certain likelihood that such undertakings are also active in other Member States.'[26] However, she diminished the relevance of this statement due to the territorial character of the tax. As it was calculated based on the turnover generated within the territory of one Member State only, it cannot be inferred that foreign-owned enterprises will be those with the highest turnover.[27]

In contrast to the cases of *Vodafone* and *Tesco*, the operation in a group structure was relevant in the *Hervis* case because of the consolidation rule that obliged Hervis

24 Similarly, see: Lang, 2021, pp. 156–157.
25 Lang, 2021, pp. 152–153; Mason, 2020, pp. 169–170.
26 Opinion Advocate General Kokott, Case C-75/18, *Vodafone Magyarország*, para. 79.
27 Opinion Advocate General Kokott, Case C-75/18, para. 80.

to aggregate the Hungarian turnover of the whole group for the purposes of calculating its own tax rate to its proportional turnover share from the overall group turnover. Thus, Hervis was taxed on a fictitious turnover due to its group membership and the judgment of the Court can be construed that it assumed that the high group turnover and the ensuing high average tax rate inherently stem from the group structure and from foreign ownership. It was only after this inherent correlation that the Court verified it by applying the majority test[28].

However, the Court admittedly did not refer to the possibility of inherent discrimination resulting from the logical correlation between multinational group companies and higher average tax rates. Therefore, the arguments that the *Hervis* judgment was partly overruled are strongly valid.

2.1.1.6. Potential justification of a prima facie discriminatory turnover-based tax

2.1.1.6.1. General remarks

In the *Tesco* and *Vodafone* cases, where the Court reviewed the conformity of these progressive turnover taxes with the freedom of establishment, the phases of comparability and justification were not reached as the Court concluded that there was no prima facie indirect discrimination in the first step. However, it is worth delving into the justification phase because some relevant implications can be inferred from such an analysis.

2.1.1.6.2. Justification of turnover taxes: The ability to pay principle, the welfare objective and the need to tackle aggressive tax planning

Unlike the Court, Advocate General Kokott analysed the justifiability of progressive turnover-based taxes. She identified the principle of taxation according to the ability to pay principle as a potential justification referring to the *Bevola* case, complemented and supported by the welfare state objective.[29] Although in the *Bevola* case the ability to pay principle played a supportive role in underpinning the main justification ground of the need to maintain the coherence of the tax system,[30] in the meantime, the State aid cases of the progressive turnover taxes[31] have shown that the ability to pay principle can serve as a standalone basis for justifying distinctions between taxpayers. Under this justification, she found that the ability to pay principle could be a legitimate underlying objective of progressive turnover taxation of companies.

28 Károlyi, 2022.

29 Opinion Advocate General Kokott, Case C-75/18, *Vodafone Magyarország,* paras. 109–114.

30 CJEU, 12 June 2018, C-650/16, *Bevola*, ECLI:EU:C:2018:424, paras. 49–50.

31 CJEU, 16 March 2021, C-562/19 P, *Commission v. Poland*, ECLI:EU:C:2021:201; CJEU, 16 March 2021, C-596/19 P, *Commission v Hungary*, ECLI:EU:C:2021:202.

Regarding the examination of the appropriateness element of the proportionality test, the Advocate General set up a lenient requirement according to which a measure is appropriate whenever the consistency between the tax and its underlying objective is not manifestly inappropriate.[32] As there is an identifiable indirect connection between the level of turnover and financial capacity of the taxpayers, such a requirement has been met.[33]

Regarding the necessity test, the Advocate General pointed out that a profit–based income tax would not entail a less onerous and equally appropriate means because a profit–based tax can also be payable in the absence of genuine financial capacity due to the non–recognition of certain items of expenditures and losses.[34]

Further, the Advocate General dedicated a standalone section to the assessment of proportionality stricto sensu, in which she examined whether the potential restriction of fundamental freedoms was disproportionate to the objective of the ability to pay (equitable burden sharing). She was of the view that this objective was important and generally recognised and that imposing a disproportionate burden on taxpayers with disproportionate financial capacity aligns with this objective insofar as it does not reach a level that chokes the given economic activity.[35] Therefore, she concluded that special taxes could be justified by the overriding public interest in taxation based on the principle of the ability to pay.[36]

It must also be noted that the Advocate General embraced a lenient approach towards Member States that attempted to justify their prima facie discriminative tax measures using the ability to pay principle. The only limit for a certain tax design to be in line with the ability to pay principle and to pass the proportionality test is to include a basis of assessment that is not completely disconnected from the financial capacity of taxpayers and to include tax rates that do not make it impossible for the taxpayers to carry on their business, i.e., that do not cause a choking effect.

An interesting aspect of Advocate General Kokott's opinion is how she used arguments related to the need to tackle tax avoidance and aggressive tax planning. Although she did not combine these grounds of justification with the ability-to-pay principle, they appeared in the proportionality test to support the appropriateness and necessity of turnover-based taxation. The argument is that as turnover (as the basis of assessment) makes these taxes less prone to tax avoidance strategies, they can more effectively approximate taxpayers' abilities to pay than profit-based taxes.[37]

But how do progressive turnover taxes as a whole relate to tax avoidance? The Advocate General referred to tax avoidance not within the context of the examined special turnover taxes but in terms of the broader horizon of corporate taxation, especially corporate income taxation, pinpointing the fact that, in Hungary, half of the

32 Opinion of Advocate General Kokott, Case C-75/18, para. 117.

33 Opinion of Advocate General Kokott, Case C-75/18, paras. 120–123.

34 Opinion of Advocate General Kokott, Case C-75/18, paras. 125–128.

35 Opinion of Advocate General Kokott, Case C-75/18, paras. 130–131.

36 Opinion of Advocate General Kokott, Case C-75/18, paras. 133–134.130–131.

37 Opinion of Advocate General Kokott, Case C-75/18, paras. 123, 128.

undertakings with the 10 highest turnovers do not pay any corporate income taxes.[38] Consequently, subjecting these entitities to a turnover tax which increases disproportionately with the level of turnover can remedy the anomalies of corporate income taxation. Such a statement is surprising as the high–turnover taxpayers carried out substantial and genuine economic activity in the given sector, hence the attainment of their high turnover.

This position can be criticized.[39] First, it is overly vague to assume that every single taxpayer with high turnover is engaged in tax avoidance.[40] It is possible that certain high turnover undertakings also realize high level of income and it is also conceivable that – especially in cost intensive segments, such as store retail trade – the lack of income tax liability stems from the fact that the high level of turnover is accompanied with high level of costs and expenditures. Second, creating a link between tax avoidance and high turnover constitutes an irrebuttable presumption as the turnover tax is due irrespective of the income tax paid.[41] Third, such 'treatment' of high turnover undertakings goes beyond the reestablishment of the non–abusive situation because it does not delve into the issue of the corporate income tax avoidance. Even if abuse was present, the turnover tax would be due merely on account of the level of turnover without any regard to the income tax liability that would have been incurred in the lack of tax avoidance. Therefore, none of the proportionality requirements are met when a hypothetical avoidance of income taxation is tackled by way of levying a different tax on the basis of turnover without taking into account the actual situation of the taxpayer in the income tax system.

2.1.2. Compatibility of a registration requirement and severe corresponding sanction with the fundamental freedoms: The Google Ireland case

The *Google Ireland* case concerned the contested procedural rules of the Hungarian advertisement tax. One of these rules prescribed a registration obligation, while the other levied a corresponding default penalty upon the failure of registration.

The registration obligation applied to all taxpayers, who have not been registered with the Hungarian Tax Authority for the purposes of any type of tax. It means that Hungarian companies were practically exonerated from this obligation because requesting a tax number and registering with the Tax Authority were inherent in the incorporation procedure of companies, therefore, this obligation, by definition, can only apply to foreign companies. Those foreign taxpayers, who were not engaged in

38 Opinion of Advocate General Kokott, Case C-75/18, para. 96.

39 Károlyi, 2022, p. 154.

40 CJEU, 5 July 2012, C-318/10, *Société d'investissement pour l'agriculture tropicale SA (SIAT)*, ECLI:EU:C:2012:415, paras. 54, 57., where the Court held that the definition of 'appreciably more advantageous tax regime' provided by the national legislation as a trigger for anti-avoidance measures was too vague without sufficient precision.

41 It is only partially mitigated by the fact that the special taxes are deductible from the corporate income tax base.

any economic activity in Hungary, except for advertising, had to register pursuant to this rule.

In case they failed to comply with this obligation, extremely rigorous default penalty were imposed on them. The initial amount of the penalty was HUF 10,000,000 (EUR 31,500) and any repeated infringement, which was established on a daily basis, entailed a default penalty, which was three times higher than the amount levied for the previous offense. The aggregate amount of default penalties was capped at HUF 1,000,000,000 (EUR 3,150,000). This final amount could be reached only within 5 days from the initial infringement.

The underlying facts of the case at issue are straightforward: Google Ireland Limited (Google), a company incorporated and being tax resident in Ireland did not have any establishment or economic activity in Hungary except for the provision of advertisement services by way of publishing advertisement on the internet in Hungarian language. Despite the fact that this advertising activity entails Hungarian advertisement tax liability, the company failed to register for advertisement tax purposes within the deadline. Consequently, the Hungarian Tax Authority imposed the default penalty on a daily basis, in accordance with the law, until the maximum amount of HUF one billion has been reached. Google brought an action against the resolution of the Tax Authority and requested its annulment. Google based its claim on the fact that only foreign undertakings are subject to the registration requirement, furthermore the amount of the default penalty is 2,000 times higher than the general level of default penalty in the Hungarian legal system and the right to effective remedy is also infringed by the limited tools of legal redress.

Advocate General Kokott did not delve into the question of whether the registration obligation had created a restriction on the freedom of establishment because she opined that it could be justified anyway by an overriding public interest, namely, the need to ensure effective fiscal supervision.[42] Regarding the registration requirement, the CJEU came to the same conclusion as the Advocate General, albeit on different grounds. The CJEU highlighted that the exemption of taxpayers who had already registered with the Tax Authority did not constitute a difference in treatment capable of restricting their freedom to provide services because it was not proven that their registration requirement would have been less onerous than for those who had to register for advertisement tax purposes.[43]

Regarding the provisions imposing a penalty for failure to comply with the registration requirement, the CJEU reiterated Advocate General Kokott's findings. Although the penalties were seemingly applied without distinguishing between resident and non-resident taxpayers, in reality, only taxpayers who were not residents in Hungary could be fined.[44] Thus, it amounted to indirect discrimination because service suppliers established in Hungary could be fined under the general rules that

42 Opinion of Advocate General Kokott, Case C-482/18, *Google Ireland Limited*, para. 61.
43 CJEU, 3 March 2020, C-482/18, *Google Ireland Limited*, ECLI:EU:C:2020:141, paras. 32, 35.
44 C-482/18, para. 41.

prescribed significantly lighter sanctions for registration failure.[45] Then, the CJEU proceeded to check whether such a difference in treatment could be justified by the need for effective fiscal supervision and collection of tax. In that regard, the imposition of penalties to ensure compliance with tax rules can be justified if it is in conformity with the proportionality requirement. However, the CJEU found the Hungarian rules to be disproportionate on several grounds. It held that the Hungarian system of penalties was disproportionate because it went beyond what was necessary, as the fines were imposed without the examination of the seriousness of the infringement, increased exponentially on a daily basis without giving the taxpayer a chance to comply with its obligations, and the final amount that had been reached within five days of the issuance of the first penalty was as high as EUR 3.100.000.[46] Consequently, the penalty regime corresponding to failure to register for advertisement tax purposes violated the freedom to provide services.

This judgment is far less controversial as those ruled on the progressive turnover tax cases. The registration requirement for advertisement tax purposes and the connecting default penalty are very good examples for indirect discrimination: due to the procedures of establishing a Hungarian company, such rules were logically and inherently only applicable to those enterprises that have not been established in Hungary and did not carry out economic activity there. Thus, this distinction could be used as textbook example for indirect discrimination. Furthermore, there was clear, less favourable treatment in the form of an extremely strict default penalty that did not fulfil any aspect of the proportionality requirement.

2.2. Taxpayers' rights under the EU Charter: the boundaries of the scope of application of the Charter: The Marcas MC case

2.2.1. Preliminary remarks

The increasing relevance of the fundamental rights in proceedings related to tax matters can be observed. Although the Charter does not contain any tax specific provisions, several generally phrased fundamental rights have been interpreted by the CJEU as including substantive and procedural taxpayers' rights as well.[47]

Although the Charter qualifies as primary EU law, it is binding for the Member States only to the extent they implement EU law pursuant to Art. 51 para. (1) of the Charter. It is a significant restriction on the applicability of the Charter in the field of taxation where Member States retained their fiscal sovereignty. The reason for this limitation is to prevent the extension of the EU competencies laid down in the TFEU via the application of the Charter. Art. 51 para. (2) expressly states that the Charter cannot result in either extending the field of application of EU law beyond the powers

45 C-482/18, paras. 42–43.
46 C-482/18, paras. 49–51.
47 Kokott, Pistone and Miller, 2021.

of the EU, or establishing any new power or task for the EU.[48] However, the CJEU began to extend the scope of situations in which Member States were considered to implement EU law or act within the scope of EU law. The term 'implementing EU law' is given a broad meaning that can be regarded to be synonymous to the notion of 'acting within the scope of EU law'.[49] The latter notion can be found in the Explanations to the Charter which explain that it follows unambiguously from the case law that 'fundamental rights defined in the context of the Union is only binding on the Member States when they act in the scope of Union law'.[50] The question arises as to when Member States act exactly within the scope of EU law. Here, the CJEU case law paved the way for two paths. According to the first line of case law, Member States are considered to act within the scope of EU law when they act as agents and implement EU law. Here, 'implementation' means both the transposition of EU directives and any act within the ambit of a directly applicable EU regulation.[51] The second line of case law renders Member States to act within the scope of EU law – even in the absence of harmonisation – in situations where domestic law amounts to a violation of primary EU law, more specifically a restriction on the free movement provisions.[52] The second line of case law clearly constituted an extension of the ambit of situtations when Member States 'act within the scope of EU law' and thus, an extension of the ambit of the Charter.

2.2.2. The Marcas MC case

The Marcas MC case primarily addressed the exact scope of the fundamental rights enshrined in the Charter in a domestic procedure related to the field of non-harmonised corporate income taxation. The underlying procedure that gave rise to the preliminary ruling request revolved around the interpretation of accounting principles. Marcas MC asserted that the tax authority violated several of its procedural guarantees enshrined in the Charter – such as the principles of legal certainty, the right to a fair trial, and the protection of legitimate expectations – and claimed that the imposed sanctions breached the principle of proportionality. Thus, the Court first had to rule on whether the provisions of the Charter were applicable to a national tax procedure in the case of a non-harmonised tax and national sanctions.

Although the case involved royalty payments derived from a cross-border licensing activity, the issue of any restriction or discrimination against this cross-border economic activity did not even come up. Therefore, only the questions related

48 Art. 51 para. (2) of the Charter of Fundamental Rights of the European Union, OJ C 326, 26.10.2012, 391–407.

49 Perrou, 2021, p. 858.

50 Explanations to the Charter, OJ C 303, 14.12.2007, 17–35.

51 van Bockel and Wattel, 2013, p. 873. with reference to the Wachauf case and further judgments. Similarly, see: Haslehner, 2017, p. 160.

52 van Bockel and Wattel, 2013, p. 873. with reference to the *ERT* case and further judgments. Similarly, regarding derogating measures from the fundamental freedoms, see: Szudoczky, 2014, pp. 138–147.

to the interpretation of the accounting principles that were harmonized at EU level had a clear connection to the transposition of a Directive, while the sanctions were imposed by purely national rules.

Nevertheless, the Court in its judgment in the Åkerberg Fransson case stipulated that the national tax penalties and criminal proceedings that are partially connected to breaches of VAT obligations could be covered by the Charter.[53] Based on the VAT Directive, Member States have an obligation to take the necessary measures for ensuring collection of all the VAT due and to prevent tax evasion. Further, based on Art. 325 of the TFEU, Member States are also obliged to counter illegal activities affecting the financial interest of the EU (as part of the VAT revenues amounts to EU own resources).[54] Consequently, the Court concluded that the domestic tax penalties and criminal proceedings constituted the implementation of certain provisions of the VAT Directive as well as Art. 325 of the TFEU, even if those domestic rules have not been adopted for the purpose to transpose the Directive.[55]

However, such a finding by the Court could not be mutatis mutandis applied to the present case. Indeed, the Court held that domestic rules related to sanctions and measures of fiscal supervision did not fall within the scope of EU law as a main rule. It is otherwise only when the sanctions concern anti-evasion measures that represent the fulfilment by the Member States of their obligation to take all measures appropriate for ensuring collection in full of a tax which generates own resources for the European Union.[56] This was not the situation in the case of the procedure of the tax audit of Marcas MC. Consequently, the Court established its lack of jurisdiction to rule on that part of the case on its merit as the situation was out of the scope of the Charter.

In summary, it can be noted that the Court consolidated its case law, including its *Åkerberg Fransson* judgment and did not go further in the extension of the meaning of 'acting within the scope of Eu law' and thus that of the ambit of the Charter in direct tax cases.

3. Secondary EU law and national law

3.1. Preliminary remarks: Tax sovereignty in the field of direct taxation

Due to Member States' insistence on preserving their tax sovereignty, EU-level harmonisation in the field of corporate taxation occured sporadically.[57] Limited

53 CJEU, 26 February 2013, C-617/10, *Åkerberg Fransson*, ECLI:EU:C:2013:105, para. 24.
54 C-617/10, paras. 25–26.
55 C-617/10, para. 28.
56 CJEU, 13 January 2022, C-363/20, *MARCAS MC*, ECLI:EU:C:2022:21, para. 38.
57 Szudoczky and Weber, 2019, pp. 34–35.

harmonisation occurred in respect of eliminating the double taxation of certain intra-group payments (dividends, interests and royalties)[58] and enhancing tax co-ordination among the tax authorities of the Member States.[59] The compliance of Hungarian tax laws with the first group of EU legislation concerning substantive tax rules has not been an issue as Hungary does not impose withholding taxes on out-bound passive income based on its domestic law irrespective of whether the situation falls within the scope of the relevant directives or not. As regards the tax coordination rules, their Hungarian implementation has been timely and accurate and has not triggered any infringement procedures.

However, two very important and far-reaching harmonisation measures occurred in the last decade: the adoption of ATAD[60] and GloBE Directives.[61] They are more likely to cause implementation complications (not only in Hungary), therefore, it is worth highlighting some actual and potential clashes between national law and these directives.

3.2. The ATAD and national law

Although the ATA Directives have already been adopted in 2016 and 2017, respectively, there has not been legal debates about their national implementation until recently. It can be explained by the fact that the implementation deadline for the various provisions of the directives expired only recently.[62] Nevertheless, clashes can be expected to draw from both the taxpayer side and the Commission.

The ATAD entails minimum standards[63], i.e., Member States are entitled to incorporate stricter anti-avoidance rules than those laid down in the directives. Therefore, over-implementation will not give rise to clash between national law and the

58 Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (recast) OJ L 345, 29.12.2011, 8–16 (Parent-Subsidiary Directive); Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States OJ L 157, 26.6.2003, 49–59 (Interest-Royalty Directive) and 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 (Codified version) OJ L 310, 25.11.2009, 39–46 (Tax Merger Directive).

59 Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC, OJ L 64, 11.3.2011, 1–12 (DAC).

60 Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market OJ L 193, 19.7.2016, 1–14 (ATAD 1); Council Directive (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries OJ L 144, 7.6.2017, 1–11 (ATAD 2).

61 Council Directive (EU) 2022/2523 of 14 December 2022 on ensuring a global minimum level of taxation for multinational enterprise groups and large–scale domestic groups in the Union ST/8778/2022/INIT, OJ L 328, 22.12.2022, 1–58 (GloBE Directive).

62 The directives prescribe several deadlines for the implementation and application of the various anti-avoidance rules, ranging between 2019 and 2024.

63 Art. 3 of ATAD.

directives. However, primary EU law, more specifically the fundamental freedoms set the boundaries for the Member States to phrase their anti-avoidance rules.[64] For instance, such rules cannot generally presume the abusive nature of certain situations and must provide the taxpayer the opportunity to present valid commercial and business reasons for its arrangements. In line with the proportionality principle, anti-abuse rules should restrict the free movement rights of taxpayers in the least onerous manner.[65] Consequently, taxpayers can be expected to challenge domestic anti-abuse rules that go beyond the minimum implementation obligations of the ATAD in light of primary EU law in preliminary ruling procedures.

The Commission also started to monitor the compliance of national transpositions with the directives. As over-implementation is not a problem under the directives, the focus of the Commission might be on the introduction of more lenient rules compared to the ones enshrined in the directives. Indeed, it also reviewed the Hungarian corporate tax rules and found that inconsistencies between national rules and the ATAD persisted. Consequently, it sent a letter of formal notice to Hungary (INFR(2023)2041) requesting that it align its corporate income tax rules with the ATAD I.[66] The Commission identified divergences between controlled foreign corporation (CFC) rules and the definition of an associated enterprise, which, under the directive, should include subsidiaries under common control.

The ATAD enables Member States to choose between the two models when introducing their CFC legislation.[67] Hungary has chosen the so-called 'CFC light' option according to which the non-distributed income of a CFC must be included in the tax base of the Member State's taxpayer (i.e. that of the parent company or head office) provided that it arose from non-genuine arrangements which have been put in place for the essential purpose of obtaining a tax advantage. An arrangement is regarded as non-genuine arrangement,

> to the extent that the entity or permanent establishment would not own the assets or would not have undertaken the risks which generate all, or part of, its income if it were not controlled by a company where the significant people functions, which are relevant to those assets and risks, are carried out and are instrumental in generating the controlled company's income.[68]

The Hungarian definition of the CFC[69] is in conformity with the wording of the ATAD regarding the above. However, there is an interesting addition in the

64 Govind and Lazarov, 2019.
65 Károlyi, 2022, pp. 148–151 and cases referred therein.
66 European Commission, 2023.
67 Such legislation creates taxing right (and obligations) for the Member State of the taxpayer in respect of the undistributed low taxed or untaxed income of the taxpayer's subsidiary/permanent establishment under certain circumstances.
68 Art. 7 para. 2 point b) of ATAD I.
69 Art. 4 para. 11 of the Hungarian Act LXXXI of 1996 on Corporate Income Tax (CITA).

Hungarian legislation which carves out permanent establishments situated in a third country from the CFC definition upon the condition that Hungary concluded a double tax treaty (DTT) with such country and based on the DTT, a permanent establishment exists in this third country and its attributable income is exempted in Hungary.[70]

Such a carve out indeed seems to be at odds with the wording of the ATAD. The only provision that might be assumed to have been the legal source of the carve out is Art. 7 para. 2 point (a) that states that 'where the controlled foreign company is resident or situated in a third country that is not party to the EEA Agreement, Member States may decide to refrain from applying the preceding subparagraph'. But the cited provision is embedded in the stricter CFC option that Hungary decided not to implement. Furthermore, the preceding subparagraph to which the given provision refers reads as: 'This point [that is the stricter CFC option] shall not apply where the controlled foreign company carries on a substantive economic activity supported by staff, equipment, assets and premises, as evidenced by relevant facts and circumstances. Such a rule clearly deals with the *Cadbury Schweppes* exception formulated in the jurisprudence of the CJEU pursuant to which freedom of establishment can only be restricted by Member States in the case of abusive situations; that is, wholly artificial arrangements. Wholly artificial arrangements occur when the entity exercises its freedom of establishment only on 'paper' because it does not have the sufficient staff, equipment, assets and premises to carry out the necessary real economic activity.[71] Thus, the preceding subparagraph ensures that the ATAD's CFC rules do not violate the free movement provisions. The cited subsequent paragraph merely allows for the Member States to introduce a stricter and more formal approach *vis-à-vis* third country CFCs because they are not covered by the freedom of establishment and the related case law.

In the light of the above, the carve-out of third country permanent establishments (PE) whose income is exempted under a DTT does not seem to be in line with the ATAD. The official explanatory memorandum of the Hungarian Corporate Income Tax Act (CITA) related to the CFC rules states that such an exclusion of third-country PEs from the CFC definition complies with the ATAD as they fall outside the scope of the Directive. However, this statement is incorrect. Art. 1 of the ATAD stipulates, '[t]his Directive applies to all taxpayers that are subject to corporate tax in one or more Member States, including permanent establishments in one or more Member States of entities resident for tax purposes in a third country'. Consequently, there is little doubt that entities subject to tax in Hungary are covered by the ATAD, and the CFC rules are applicable to their low-taxed third country subsidiaries and permanent establishments. Although the usage of the expressions of 'paragraph', 'subparagraph', and 'point' in the ATAD, including its English version, are rather inconsistent and

70 Art. 4 para. 11 point h) of CITA.

71 CJEU, 12 September 2006, C-196/04, *Cadbury Schweppes and Cadbury Schweppes Overseas*, ECLI:EU:C:2006:544, paras. 51, 67.

confusing, the structure of the CFC rules implies that such a carve-out cannot be inferred from the Directive.

On the other hand, the application of the CFC rules is problematic *vis-á-vis* third country PEs because it raises the problem of a DTT override. Third countries did not contemplate that a future EU directive will affect their international agreements concluded with EU Member States and EU Member States should be able to comply with their obligation stemming from EU law without infringing their other international agreements. Although this issue goes beyond the boundaries of the present contribution, the relationship of potential DTT override and EU law obligation was worth mentioning as it could occur more frequently in various direct tax fields not only covered by ATAD but also covered by the global minimum tax directive.

As a reaction to the formal notice of the Commission, the Hungarian Ministry of Finance submitted and the Hungarian Parliament adopted an amendment according to which the above–cited provision will be repealed and a new provision will be enacted. The new rule merely states that in the case of checking whether a foreign company qualifies as a CFC for Hungarian tax purposes (i.e., whether it is subject to low-taxation), its foreign PE needs not to be taken into account if the country, where the foreign company is tax resident, exempts or does not subject to tax the income of such foreign PE to the contested rules.[72]

The Commission also noted that the Hungarian definition of associated enterprises was a bit narrower in scope for the purposes of ATAD rules than the one prescribed by the Directive. In that regard, the Hungarian parliament already took measures to eliminate this inconsistency and sister companies with an at least 25% of common ownership will also be included in the scope of the associated enterprise concept for CFC purposes.[73]

3.3. The GloBE and its national transposition

3.3.1. Process to the adoption of the directive

The global minimum tax directive has been preceded by an international agreement under the auspices of the OECD accepted by a large part of the international community in October 2021 on the Two-Pillar solution, including the commitment to implement the GloBE rules to achieve the taxation of multinational groups at an effective minimum tax rate of 15%. The consensus also ended the unilateral application of the digital services taxes (DSTs) by abolishing/suspending

72 Art. 12 of the draft legislation on the amendment of certain tax provisions submitted by the Ministry of Finance. See: *Egyes adótörvények módosításáról szóló törvénytervezet* [Online]. Available at: https://kormany.hu/dokumentumtar/egyes-adotorvenyek-modositasarol-szolo-torvenytervezet (Accessed: 30 October 2023).

73 Art. 12 of the draft legislation on the amendment of certain tax provisions submitted by the Ministry of Finance.

such temporary measures.[74] After the global agreement, the OECD began to publish related materials on GloBE rules. First, it released the GloBE Model Rules[75] in December 2021, followed by the related Commentary[76] and Illustrative Examples[77] in March 2022.

However, the committed states were not rushing to transposing the model rules into their domestic legal system. At the end of December 2022, the implementation of GloBE rules got an important impetus as they have gained a binding form at EU level when – following a fierce and politicized bargaining process[78] – the Member States eventually unanimously reached an agreement on the GloBE Directive Proposal[79] with an implementation deadline set by the end of 2023.[80] After the groundbreaking consensus, several other countries followed suit and announced the introduction of GloBE rules or certain elements of them in their domestic legal systems.[81]

3.3.2. The GloBE rules

The GloBE's scope affects multinational enterprises (MNEs) with a certain level of revenue. Specifically, it covers the constituent entities (CE) of multinational groups that generate an aggregate annual revenue (in at least two of the four preceding years) of at least EUR 750 million based on the consolidated financial statements of the ultimate parent entity (UPE).[82] The scope of the EU GloBE Directive covers purely domestic groups to which the same revenue threshold applies. This extended scope is meant to ensure that the GloBE rules comply with the fundamental freedoms.[83]

The GloBE rules entail three main sets of technical rules that serve the same purpose: to ensure that the in-scope MNEs are subject to an effective tax rate (ETR) of at least 15% in each jurisdiction in which they operate. These are called the Income Inclusion Rules (IIR), the Undertaxed Payment (or, as recently referred to, Undertaxed Profits) Rules (UTPR), and the Subject-to-Tax Rules (STTR). The first two are meant to be implemented in domestic legal systems; meanwhile, the third set of rules – which notably has priority in the order of the application of these rules – ensues from the modification of DTTs. It must be noted that the latter, i.e., the STTR

74 OECD, 2021b. More recently: OECD, 2023a.
75 OECD, 2021a. (hereinafter: GloBE Model Rules).
76 OECD, 2022a. (hereinafter: Commentary to the GloBE Model Rules).
77 OECD, 2022b. (hereinafter: GloBE Examples).
78 *EU Member States unanimously adopt Directive implementing Pillar Two Global Minimum Tax rules*, 2022.
79 GloBE Directive.
80 European Council and Council of the European Union, 2022.
81 For example Japan and South-Korea, see: *Japan 2023 tax reform proposals include Pillar Two legislation*, 2023; *Korea enacts new global minimum tax rules to align with OECD BEPS 2.0 Pillar Two – Orbitax*, 2023.
82 GloBE Model Rules, Art. 1.1.
83 GloBE Directive, Explanatory Memorandum, p. 6.

rule is not included in the Model Rules, nor in the GloBE Directive, consequently its date of implementation and its details are still uncertain.[84]

The IIR will work as a sort of Top-up Tax that the residence state of the ultimate parent entity (UPE) of the multinational group can primarily (preceding the intermediate parent companies) levy on the low taxed profits of a subsidiary that had not been subject to the minimum profit tax of 15 % in its home state.[85] It is specific to the GloBE rules, that the minimum effective tax rate (ETR) is calculated at a jurisdictional level.[86] Unlike a CFC rule, the IIR does not apply the prevailing tax rate in the UPE country, rather the top-up Tax is levied up to the extent that the ETR of the CEs concerned reaches the 15%. However, the low-tax jurisdiction is entitled to introduce a domestic Top-Up Tax and collect the missing tax on its own.

The second pillar of the charging provisions of the GloBE rules is the UTPR, which is applied as a backstop rule if the IIR is not applicable. In such situations, when the IIR cannot be applied because the low-tax jurisdiction is the country of the UPE or no qualifying IIR rules are in force in the UPE country (or in any other lower-tier parent entity countries), then, the UTPR comes to the fore. It would function as denying the deduction of certain otherwise deductible items or requiring them to make an equivalent adjustment under domestic law (in an amount that results in an additional tax expense for the affected CEs that is equal to the UTPR Top-up Tax).[87] The allocation of top-up tax under the UTPR would be determined based on a formulaic apportionment that is calculated on the basis of the number of employees and the total value of tangible assets in the given jurisdiction.[88]

3.3.3. Inherent risks of multilevel rule-making procedures

The GloBE rules will be effective in the EU by 2024. As a result, currently the conflict of national implementation with the EU rules is out of question. Nevertheless, besides the regular transposition issues, there is an extra layer of caveat: the overlap of EU and international rules is susceptible to give rise to future complications. When the GloBE Directive was adopted at the end of 2022, it was drafted in accordance with already-published OECD documents – namely, the GloBE Model Rules and their Commentary and Examples – with some necessary modifications to align the Directive with primary EU law. Indeed, recitals to the Directive provide that the Directive closely follows the content and structure of the GloBE Model Rules

84 As it stands now, this will entail additional taxation of certain cross-border payments between connected companies where the recipient is subject to a nominal corporate tax rate below 9%. This will only apply to specific types of payments, such as interest, royalties, insurance premiums, guarantees, and certain rental payments as well as payments for services. See: OECD, 2023b.

85 GloBE Model Rules, Art. 2.1.1.

86 GloBE Model Rules, Art. 5.1.1.

87 GloBE Model Rules, Arts. 2.4.1–2.4.2.

88 GloBE Model Rules, Art. 2.6.1.

and implements them at the EU level in accordance with the common approach included in the GloBE Model Rules.[89]

However, since the adoption of the Directive, quite some developments have occurred at the OECD level, with new OECD documents, including three pieces of Administrative Guidance and an Implementation Handbook, issued.[90] The result of these new, post-Directive documents goes beyond merely clarifying the GloBE Model Rules and creating substantive rules that cannot be deduced from the latter. Such situation entails that these documents create new rules compared to the ones laid down in the Directive as well. The Directive and its recitals do not mention that any relevance should be given to future OECD documents during the course of the interpretation of the Directive. Such a situation can raise plenty of problems at EU level where the adopted Directive is based on the GloBE Model Rules.

Thus, the question can be posed what relevance should be attributed to the new developments at OECD level in the interpretation of EU law, i.e., that of the GloBE Directive.[91]

The theoretical short answer to this question should be none. One must agree with Advocate General Kokott that a concept of a directive qualifies as an autonomous EU law concept and must be independent of the definitions applied at the OECD level. The latter can serve as a source of inspiration for interpretation only to the extent it is explicitly indicated in the text of the Directive or its drafting history.[92] Even if this is the case, only a static approach is acceptable, that is, only those OECD documents can bear relevance for the interpretation of an EU law concept that existed at the time of the adoption of the Directive – otherwise, the interpretation of EU law could be influenced by OECD countries, which would raise serious legitimacy questions.[93]

In *Berlio*z,[94] when the CJEU interpreted the term ‘foreseeably relevant information’, it considered Art. 26 of the OECD Model Convention and its Commentary. It must be noted that in the explanatory memorandum of the mutual assistance directive (based on a proposal in 2009), an explicit reference was made to Art. 26 of the OECD Model Convention, which was modified in 2012. However, the CJEU has given relevance to it in the case that started in 2014. Seemingly, this amounted to a dynamic application of the OECD Model Convention and its Commentary; however, the new rules were consistent with the EU Directive even after their modification.

89 Recitals 6 and 24 of the GloBE Directive.

90 OECD, 2023c; OECD, 2023d; OECD 2023e; OECD, 2023f.

91 For an analysis to what extent the Court of Justice of the European Union takes into account OECD developments prior and after the birth of the EU legislation, see: Geringer 2023. Nevertheless, we must submit as problematic the lack of clear reference by the EU legislation itself to the OECD material to pay any heed to the latter from a democratic point of view, as not all the Member States are members of the Council of the OECD.

92 Opinion of Advocate General Kokott, C-115/16, C-118/16, C-119/16 and C-299/16, *N Luxembourg 1 and others*, paras. 49–52.

93 Opinion of Advocate General Kokott, C-115/16, C-118/16, C-119/16 and C-299/16, para. 53.

94 CJEU, 16 May 2017, Case C-682/15, *Berlioz*, ECLI:EU:C:2017:373.

In the Danish beneficial ownership cases, the draft documents of the EU Directive contained an explicit reference to the 1996 version of the OECD Model Convention. Yet, later amendments were also taken into account by the CJEU in interpreting the same term of the Directive.[95] Thus, the CJEU adopted a more inclusive approach than that proposed by Advocate General Kokott.

However, in the *Cobelfret* case, which concerned a domestic implementation of the Parent-Subsidiary Directive, the Court was stricter with the Member States and held that secondary EU law must be interpreted on the basis of EU sources within the legal framework of the EU and did not allow for consideration of the rules of the OECD Model Convention to justify the violation of the Directive.[96]

In the case of the GloBE Directive, there is only explicit reference to the GloBE Model Rules and their Commentary. Consequently, it can be derived from the jurisprudence of the CJEU that any subsequent set of guidelines at the OECD level can only play a role in the interpretation of the GloBE Directive to the extent that it merely clarifies the provisions of the GloBE Model Rules. If they go further and add new or even contradictory rules, it would be problematic to use them as interpretative tools for secondary EU law legislation. This situation can cause special implementation problems with respect to the GloBE Directive because the Directive either will not be able to catch up with the latest and internationally agreed rules on a global minimum tax, or the legitimacy of EU rules will be endangered if they are interpreted in light of later guidance issued by the OECD, to which not all Member States are parties. In the authors' view, the fact that both the ECOFIN Council and the Commission issued a statement on 9 November 2023 that they consider all subsequent Inclusive Framework (IF) developments in the field of GloBE rules to be consistent with the EU GloBE Directive does not eliminate the problem.[97] This may result in a pragmatic approach, whereby the latter guidance automatically overrides the original wording of the Directive in the event of a clash; however, dogmatically, it is an unacceptable solution that raises an array of problems from the perspective of legitimacy and legal certainty.

4. Conclusions

The introductory chapter on EU tax law pointed out that tax sovereignty, particularly in the field of direct taxation, is crucial for Member States and they insist on their liberty to collect revenue from direct taxes as they wish (provided that the

95 CJEU, 26 February 2019, C-115/16, C-118/16, C-119/16 and C-299/16, *N Luxembourg 1 and others*, ECLI:EU:C:2019:134, para. 90.

96 CJEU, 12 February 2009, C.138/07, *Cobelfret*, ECLI:EU:C:2009:82., paras. 55–57.

97 Council of the European Union, 2023.

design is compliant with EU law requirements). Furthermore, taxation can be considered a macroeconomic tool for achieving certain economic goals. For instance, attracting foreign direct investment by creating a beneficial and competitive tax system for investors.

Another policy goal that Member States may strive to achieve through tax measures is the favourability and protection of domestic taxpayers. However, this policy objective is unacceptable within the internal market, and the fundamental freedom provisions clearly prohibit discriminative measures against nationals of other Member States. Consequently, Member States usually refrain from directly treating foreigners less favourably than domestic taxpayers. Nevertheless, they often attempt to achieve such an effect indirectly, devising their tax systems in a seemingly neutral way that, in effect, attributes a disadvantage to cross-border situations. Discrimination in an indirect form is also forbidden pursuant to the free movement provisions; however, it is often very difficult to delineate such situations from acceptable and neutral distinctions.

Several recent Hungarian cases presented in the preceding sections of this contribution revolved around the delicate issue of defining indirect discrimination. The turnover–based business tax cases showed that the Court seems to have taken a more lenient approach than in its previous case law *vis-à-vis* Member States. This tacitly requires a logical link between the distinguishing criterion and foreign nationality, which means that the discriminatory impact must be inherent in the design of the tax rather than the outcome of a special market situation. The very same cases proved that the ability-to-pay principle received the rank of a standalone justification and legitimate aim to be pursued by the Member States, which enjoy great liberty in implementing such an objective through their tax systems – the only limit being the standard of manifest inconsistency of the tax design with the ability-to-pay principle. However, highly progressive turnover-based taxes have not yet reached this limit.

Taxpayer rights enshrined in the Charter gain growing relevance in the jurisprudence of the CJEU not only because the taxpayers are getting more aware of their substantive rights laid down in the Charter but also because the ambit of the Charter's application is more extended than the wording of Art. 51 para. (1) would suggest. Nevertheless, the connected Hungarian case of *Marcas MC* can be regarded as a consolidation of the case law, without any further extension.

As far as secondary EU law is concerned, it can be stated that Hungary is largely compliant with the direct tax related directives in the course of transposing them. Nevertheless, the Commission discovered some inconsistencies with respect to the ATAD CFC rules, and the Hungarian answer in the form of a proposal for a legislative amendment does not necessarily eliminate all concerns. This may lead to an infringement procedure. Furthermore, the transposition of the GloBE Directive might result in plenty of legal concerns throughout the EU due to the fact that the development of GloBE rules took place both at OECD and EU level and the adoption of the EU Directive has been followed by new OECD documents. The interpretation of the

Directive in the light of these new developments is problematic; however, the inconsistent application of GloBE rules within and outside the EU is undesirable. likewise undesired. The future will tell how this issue will be handled. This is however not a country–specific problem.

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