iris plus
LEGAL OBSERVATIONS
OF THE EUROPEAN AUDIOVISUAL OBSERVATORY

The Impact of EC Law on the Taxation of the European Audiovisual Industry

Hasan Bermek

EDITORIAL

"Money makes the world go round" and taxing products and services is one way in which it can be raised. And yet states can also abstain from collecting taxes or indeed reduce tax burdens and thus leave the money in the pocket of companies and individuals.

How states organise their tax systems, to whom they grant tax exemptions and benefits and on whom they spend money from the tax-filled budget, is driven by specific policies such as the support of certain industries. Among them features the audiovisual industry, to which tax law is often benevolent because of the states' desire to promote national culture and to build up a forward-looking sector.

To the extent that tax related policies translate into national rules which influence the EC internal market, for example because they invite state protectionism, they collide with EC law. It is therefore not surprising that national tax law meets with the scrutiny of EC policy makers and triggers legislative action in Brussels.

If fiscal support policies concerning the audiovisual sector are to succeed, Europe's creative industry and competent policy makers need reliable information on the impact that EC law has on the taxation of the European audiovisual sector.

In this IRIS plus Hasan Bermek analyses a wide spectrum of tax issues relevant to the audiovisual sector and demonstrates the various ways in which these issues relate. His article is both a guide to the legal framework and a description of the areas which may still be regarded as requiring attention. It merits attentive and thorough reading!

Strasbourg, November 2007

Susanne Nikoltchev
IRIS Coordinator
Head of the Department for Legal Information
European Audiovisual Observatory

IRIS *plus* is a supplement to **IRIS,** *Legal Observations of the European Audiovisual Observatory,* **Issue 2007-12**

OBSERVATOIRE EUROPÉEN DE L'AUDIOVISUEL
EUROPEAN AUDIOVISUAL OBSERVATORY
EUROPÄISCHE AUDIOVISUELLE INFORMATIONSSTELLE

76 ALLEE DE LA ROBERTSAU • F-67000 STRASBOURG
TEL. +33 (0)3 88 14 44 00 • FAX +33 (0)3 88 14 44 19
http://www.obs.coe.int
e-mail: obs@obs.coe.int

The Impact of EC Law on the Taxation of the European Audiovisual Industry

Hasan Bermek
European Audiovisual Observatory

The action of the European Community (EC) in the field of taxation closely reflects the development of EC law in general, and the evolution of the Community's priorities, starting from the establishment of the customs union to the creation of the common market and beyond. This is fully in keeping with Article 2 of the EC Treaty, which provides that the means to reach the social and economic objectives of the European Community is the establishment of a common market and an economic and monetary union.

The action of the Community in the field of taxation has also been shaped by the tasks explicitly assigned to it by Article 3, paragraph 1 of the Treaty. These include, notably:
- an internal market characterised by the abolition, as between Member States, of obstacles to the free movement of goods, persons, services and capital (sub-paragraph c);
- a system ensuring that competition in the internal market is not distorted (sub-paragraph g);
- the approximation of the laws of Member States to the extent required for the functioning of the common market (sub-paragraph h).

It is clear that fiscal matters are very relevant for all these activities and that national fiscal laws have a significant impact on the functioning of the common market. Fiscal obstacles to the entering of the national market of goods, services, income or capital or to the emigration of taxpayers are an obvious example of this potential impact. A differential fiscal treatment of foreign and domestic products, services and income may also discourage the exercise of the fundamental EC Treaty freedoms. Finally, important discrepancies between national tax legislations, rules and administrative practices, even where these do not pursue protectionist aims, can lead to unfair fiscal competition between Member States, as well as the distortion and fragmentation of the internal market along national borders.

A certain degree of integration in fiscal matters is therefore essential for the European Community, in order for it to pursue the aims, and to carry out the activities, attributed to it by the EC Treaty. This integration is, however, not an end in itself, but a necessary precondition for the proper functioning of the internal market.

Consequently, while the Community does not have a proper tax policy of its own (for example, it cannot levy taxes, except for a tax on the salaries of its own civil servants), it has developed a considerable body of law relating to the harmonisation of national tax policies and the elimination of national tax measures considered as unduly interfering with the common market.

As fiscal barriers may, thus, constitute important obstacles to the integration of European markets, they can be seen as an additional impediment for the establishment of a truly European audiovisual sector taking full advantage of the internal market and the economies of scale this implies. While the fragmentation of this sector is certainly also due to other factors, such as linguistic or cultural barriers, fiscal obstacles between Member States of the EU are an additional element contributing to the competitive disadvantage faced by the European audiovisual industry at the international level.

In the following, I shall provide a brief overview of the general legal framework in the European Community concerning fiscal matters (I). It is then useful to look in more detail at a number of tax-related issues of particular relevance to the audiovisual sector. These include the relationship between EC competition law and national tax incentives for films and audiovisual works, VAT rules affecting the audiovisual sector, as well as issues concerning direct taxation, and in particular, cross-border remuneration (II).

I. Taxation and the European Community – Legal Bases and General Legal Framework

When analysing the process of integration of national tax systems[1] at the European level, an important distinction can be made between positive and negative integration. In effect, the EC Treaty provides legal bases for what one may call *positive* integration, which implies an active harmonisation and co-ordination in matters relating to taxation, in particular through specific EC legislation relating to tax issues (A). The EC Treaty operates a fundamental distinction between two groups of taxes in this respect: whereas it provides a distinct and clear legal basis for indirect taxes, resulting in a correspondingly higher degree of integration, direct taxes are subject to more general provisions concerning harmonisation.

This form of integration can be clearly distinguished from *negative* integration, which implies the amendment or abolition of discriminatory tax rules and practices, or other restrictive features of national tax systems. One of the main impulses for such negative integration has been the case law of the European Court of Justice striking down tax measures incompatible with EC Treaty provisions, and affecting, predominantly, direct taxes (B).

A. Positive Integration

As mentioned above, the positive integration bases provided in the EC Treaty are very different regarding indirect and direct taxes, although it is interesting to note that the Treaty itself does not provide a clear legal definition of "direct" and "indirect" taxes. Generally, indirect taxes are understood to be taxes collected by an intermediary on behalf of the authorities from the person who bears the ultimate economic burden of the tax (such as the customer). They include turnover taxes, the best known example of which is value added tax (VAT), as well as excise duties. By contrast, direct taxes are paid directly to the authorities by the legal or natural person on whom they are imposed. Examples include income tax, corporation tax, or taxes on certain transfers (e.g. real estate, shares, bonds, inheritance, etc.).

This fundamental difference in treatment between direct and indirect taxes can be traced back to the priorities of the EC Treaty: as their generating factor is the provision of goods and services, indirect taxes such as VAT or excise duties, can easily be misused by states to create barriers to the free movement of goods and services, as a replacement for those abolished by the Treaty, such as customs tariffs. The importance attached by the EC Treaty to the harmonisation of indirect taxes shows in effect that the EC's roots lie in a free trade area.[2]

While the legal basis for positive integration is explicit for indirect taxes (1), no such explicit provision exists for direct taxes. Thus harmonisation regarding direct taxes has been based on more general Treaty provisions (2). This state of affairs has resulted in very different levels of harmonisation for the two groups of taxes. Whereas the former have been substantially harmonised, primarily through positive legislative integration, and notably the VAT directives, the positive integration accomplishments in the field of direct taxes have been much more modest.

1) Indirect Taxes

The EC Treaty, under Article 93, specifically provides that the Council shall, acting **unanimously** on a proposal from the Commission and after consulting the European Parliament and the Economic and Social Committee:

> "adopt provisions for the harmonization of legislation concerning turnover taxes, excise duties and other forms of indirect taxation to the extent that such harmonisation is necessary to ensure the establishment and the functioning of the internal market."

An important body of secondary law, i.e. a large number of Directives and Regulations, have already been agreed in the area of indirect taxes on the basis of this Article. As will be examined in more detail below (Chapter II.B), harmonisation, in particular in relation to VAT, has reached a relatively advanced stage, so that VAT can be considered an exception to the general rule of national fiscal sovereignty. States are bound to levy VAT, and no other turnover taxes, within a certain bracket of tax rates, in order to achieve a "level playing field".

Significantly, for historical reasons, a part of the Community budget is funded by a small percentage of the VAT revenues of the Member States. This is another element demonstrating the close relationship between EC law and VAT.

2) Direct Taxes

Whereas the EC Treaty provides a distinct and clear legal basis for the harmonisation of indirect taxes, direct taxes can only be harmonised through the use of more general Treaty provisions. This implies that states retain a higher degree of fiscal sovereignty vis-à-vis direct taxes, which must, however, be exercised in accordance with other, more general Treaty principles.

The European Court of Justice (ECJ) has recognised this state of affairs by using the following formula when referring to direct taxes:

> "Although, as Community law stands at present, direct taxation does not as such fall within the purview of the Community, the powers retained by the Member States must nevertheless be exercised consistently with Community law."[3]

The lack of an explicit legal basis for harmonisation in the area of direct taxes has led to Community action based on more general principles. In particular, Article 94 provides for the Council, acting **unanimously** on a proposal from the Commission and after consulting the European Parliament and the Economic and Social Committee, to "adopt provisions for the approximation of such laws, regulations or administrative provisions of the Member States as directly affect the establishment or functioning of the common market".[4] So far, only four direct tax directives have been adopted on the basis of Article 94, three of which concern corporation tax and one concerns income tax. These are, in chronological order:

- the Merger Directive,[5] on tax consequences of mergers of companies of different Member States;
- the Parent-Subsidiary Directive[6], dealing with cross-border, intra-group income flows (see Chapter II.C.1 below);
- the Savings Interest Directive,[7] which aims to enable the effective taxation of interest payments made in one Member State to beneficial owners in another Member State, in accordance with the laws of the latter Member State;
- the Interest and Royalty Directive,[8] of particular relevance to the audiovisual industry, on intra-group cross-border interest and royalty payments (see Chapter II.C.1 below).

With the exception of the Merger Directive, all these measures deal primarily with the question of withholding taxes and double taxation which, in the context of the EC, is arguably the aspect of direct taxation with the highest relevance to the proper functioning of the Internal Market.

Community legislation on direct taxation has also been adopted under wider provisions of the Treaty. For example, Article 308 of the Treaty, which allows the Community to take action in cases where the Treaty has not provided the necessary power, has been the legal basis of the EC Regulation on the European Economic Interest Grouping (EEIG), which includes specific tax arrangements.[9] By contrast, the legislation providing for the European Company *(Societas Europaea)*, which was also adopted under Article 308 does not contain tax elements.

Another relevant provision regarding direct taxation is Article 293 of the EC Treaty. This Article provides that "Member States shall, so far as is necessary, enter into negotiations with each other with a view to securing for the benefit of their nationals […] the abolition of double taxation within the Community." This Article, which may be considered merely as a declaration of intent, as it does not impose a formal obligation on Member States to eliminate double taxation, has nonetheless served as the legal basis for an Arbitration Convention,[10] which provides for an arbitration procedure in cases where two tax authorities fail to reach an agreement on a double taxation claim.

The question of double taxation, and of related bilateral treaties and their status in Community law is a complex issue, which is also of relevance for the audiovisual industry (see Chapter II.C below). This area has been the subject of increasing attention from the Commission in recent years.

Indeed, one can generally observe a growing focus on direct tax matters by the Commission. The main reason for this, in the words of the Commission itself, is that "Community law relating to taxation focused for the first thirty years of its existence on indirect taxation […] as this was a major obstacle to the establishment of the internal market. [Direct taxation is] a subject, which the Community only began to look into seriously after the internal market had been established."[11]

B. Negative Integration

Regardless of the level of positive integration achieved in tax matters, the respect of the fundamental Treaty principles has had a profound impact on the policy and legislation of EU Member States, including national tax systems. Foremost among these principles are the free movement of goods, workers, services and capital and the freedom of establishment (Articles 29, 39, 43, 49 and 56 of the EC Treaty) and the principle of non-discrimination.[12] The case law of the ECJ reveals numerous examples of restrictive tax measures being struck down due to their incompatibility with these principles.

Direct taxes, in particular, have primarily been subject to negative integration, i.e. prohibitions derived from other EC policy areas and general principles. Negative integration is especially important in direct tax matters because national tax systems tend to distinguish between domestic-source income and foreign-source income and between resident taxpayers and non-resident taxpayers, whereas the EC Treaty forbids all discrimination of undertakings and nationals of other Member States.

In this respect, discrimination can be overt (using the criterion of nationality) or covert (using other criteria, such as residence, that amount to a similar result[13]). As an example of the latter, a national measure excluding newspapers printed abroad from a tax benefit applying to newspapers printed on the territory of the state concerned is incompatible with the EC Treaty.[14] Similarly, fiscal measures that disadvantage cross-border insurance or pension contracts compared to domestic contracts are prohibited by EC law.[15] Indeed, tax measures are in principle prohibited simply by virtue of the fact that they make it "less attractive" for EU nationals to exercise their Treaty freedoms.[16]

Under the established case law of the ECJ, such restrictive measures can only be admitted in certain cases. In this respect, the Court applies its rule of reason test, which it formulated as follows:

> "It follows […] from the Court' s case-law that national measures liable to hinder or make less attractive the exercise of fundamental freedoms guaranteed by the Treaty must fulfil four conditions: they must be applied in a non-discriminatory manner; they must be justified by imperative requirements in the general interest; they must be suitable for securing the attainment of the objective which they pursue; and they must not go beyond what is necessary in order to attain it."[17]

Whereas there are a number of grounds for derogation explicitly codified in the EC Treaty for the individual freedoms[18], these have so far not been applied to tax measures. However the ECJ has accepted three public interest justifications in its case-law for the restrictive tax treatment of cross-border situations:

- Prevention of tax avoidance and fraud: the ECJ has a very narrow interpretation of this derogation and has so far not applied it in concreto.
- The need for effective fiscal supervision: this justification has been applied to measures such as requirements to keep double accounts[19] or to provide special proofs to ascertain the amount of costs deductible.[20]
- Coherence of the national tax system: this justification concerns the link between the deductions of investments or contributions (e.g. life insurance premiums) and the taxation of future benefits. Under certain circumstances, a Member State may be allowed to deny a deduction, when the taxation of a future benefit cannot be guaranteed.[21] This is of particular relevance for "withholding taxes" (also known as "exit taxes").

It is important to stress that these derogations will only be admitted when the measures in question are proportionate to the aim they pursue, i.e. when there is no less restrictive measure that could serve the same purpose.

A significant part of the ECJ's case-law relating to taxation deals with the question of double taxation. This is an area in which judgments of the Court have often pre-empted legislative action by the Community (see Chapter II.C).

Another relevant area of Community competence that has had a restrictive impact on national tax systems is competition law, and in particular the Treaty provisions concerning State aid (Articles 87-89). An increasing number of European states resort to tax incentives in order to support the film and audiovisual sectors in Europe. As will be seen below, the Commission has increasingly taken this fact into account in its decisions dealing with these sectors which, owing to their special status of being both of economic and cultural significance, have resulted in a fairly specific EC policy (see Chapter II.A).

While not directly relevant for the audiovisual sector, one should also note that the Economic and Monetary Union (EMU), in addition to entirely transferring the monetary policy competence of the Eurozone States to the Community level, had a global impact on the fiscal sovereignty of all Member States. Thus, the Maastricht convergence criteria, the Stability and Growth Pact (SGP) and the Excessive Deficit Procedure (Article 104 of the EC Treaty) impose maximum limits on budget deficit and national debt as percentages of GDP and introduce a procedure of fiscal monitoring.

Considering that monetary policy and fiscal policy are the only two macroeconomic tools that governments have at their disposal to manage their economy, the wholesale communitisation of the former (for Eurozone States), and the limits set on the latter, might in part explain the increasing resistance of Member States to further harmonisation of both indirect and direct taxation. This, together with the fact that EC action in fiscal matters is subject to the rule of unanimity within the Council, has consistently frustrated the Commission's efforts to pursue positive fiscal integration and could account for the fact that it increasingly resorts to soft-law alternatives to legislative action, such as Codes of Conduct, Recommendations, Guidelines, Communications or Strategy Papers.[22]

II. Issues of Particular Relevance to the Audiovisual Industry

Having examined the legal basis for Community action in tax matters, it is expedient to concentrate on three issues relating to EC law, which have a considerable influence on the European audiovisual sector. The relation between EC competition law and national tax incentives for films and audiovisual works demonstrates how a seemingly distant policy area can affect national tax systems, providing a clear example of negative integration (A). EC legislation regarding indirect taxes, and namely VAT rules affecting the audiovisual sector, is another important area (B). Finally, the question of direct taxes and cross-border remuneration will be examined (C).

A. Competition Law and National Fiscal Incentive Schemes for the Audiovisual Sector

Competition law, and in particular the Treaty provisions concerning State aid (Articles 87-89), is an area of EC law which has had a significant and restrictive impact on national tax systems. For the purposes of Community competition law, which seeks to create a "level playing field" within the internal market, "any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the common market".[23]

While State aid corresponding to this definition is presumed to be incompatible with the EC Treaty, certain types of aid can be exempted from this general prohibition, provided that they pursue certain policy objectives enumerated in the Treaty. Thus, since the adoption of the Maastricht Treaty, "aid to promote culture and heritage conservation where such aid does not affect trading conditions and competition in the Community to an extent that is contrary to the common interest"[24] may be considered compatible with the common market. The application of such exemptions is subject to the Commission's approval following a strict ex-ante notification procedure.

Aid granted to the audiovisual sector is thus subject to the review of the Commission. Starting from 1988 with its decision concerning aid granted to Greek films,[25] the Commission developed a considerable body of case law concerning State aid to the film and audiovisual sectors. This has been complemented in 2001 by the Commission's "Cinema Communication",[26] which specifies the criteria used by the Commission in order to determine whether the exemption contained in Art. 87(3)d of the EC Treaty applies to a particular measure. In addition to the essential condition of compatibility with the general principles of the Treaty (such as the four Treaty freedoms or the principle of non-discrimination), the notified aid must satisfy four criteria:

- It should benefit cultural products, cinematographic or audiovisual works, taking into account the fact that the definition of the concept of cultural product is left to the appreciation of Member States;
- The producers must be free to spend at least 20% of the total production budget in other Member States without forfeiting the entitlement to receive the aid in full;
- The amount of the aid must not exceed a ceiling of 50% of the total cost of the project in terms of aid intensity per film (except in the case of difficult or low budget films);
- Any additional aid in respect of certain specific technical production services is prohibited.

The Cinema Communication has recently been extended until 31 December 2009.[27]

1) Applicability of State Aid Rules to Tax Incentives

The condition expressed by the formula "granted through State resources" does not necessarily require direct funding and includes foregoing tax revenue. By refraining from collecting the fair share of taxes from an undertaking, the State confers on it a clear advantage over its competitors. The corresponding loss for the State Treasury should, in principle, be compensated by the taxation of the future profits of the beneficiaries of these schemes, as well as additional fiscal revenues generated by increased economic activity in the relevant sectors. However, this is by no means guaranteed, especially concerning the audiovisual industry, owing to the risks inherent to this sector.

In its relevant notice, the Commission identified various possibilities for a taxation system from which such advantages can be derived. This non-exhaustive list includes reductions in the tax base (e.g. special deductions, special or accelerated depreciation arrangements or the entering of reserves on the balance sheet), a total or partial reduction in the amount of tax (through exemptions or tax credits) or a deferment, cancellation or even special rescheduling of an undertaking's normal tax debt.[28]

Thus, tax-based measures clearly qualify as State aid in the context of EC law and have been recognised as such from an early stage.[29] This is also in accordance with the framework of international law, as the GATT Anti-Subsidy Codex of 1994 makes clear that tax incentives are regarded as subsidies according to Article VI GATT.[30] Consequently, due to its competence in State aid matters, the Commission can limit the competence of Member States regarding the introduction of tax incentives. It has thus played a significant role in the negative integration of European tax systems, by limiting the fiscal sovereignty of EC Member States regarding State aid schemes that take the form of tax measures.

The share of tax-based State aid schemes has been constantly increasing. While aid in the form of direct grants still accounts for the majority of State aid distributed in Europe, according to the most recent figures published by the Commission, during the 2003-2005 period, tax exemptions made up almost 40% of the total aid awarded in the EU.[31] The distribution among Member States is however far from being homogenous – whereas tax exemptions made up 70% of total aid in Portugal, Slovakia and Sweden, for example, Belgium, Denmark, Luxembourg and Austria provided at least 85% of their aid in the form of direct grants.

2) Tax Incentives and the Audiovisual Sector

While there are clear differences between different European States, the general trend of increasingly resorting to tax-based measures for State aid is also reflected in the aid granted to the film and audiovisual sectors in Europe. The last decade has seen an important proliferation of tax incentives for the audiovisual sector among European States, as attested by the body of decisions adopted by the Commission in recent years.

When examining such fiscal incentives, the Commission applies the same criteria defined in its cinema Communication (see above). It is interesting to note that the Commission also explicitly referred to such fiscal incentives in this Communication, without taking a position vis-à-vis this phenomenon:

> "Certain questions arise concerning […] the effect of fiscal measures in force in the Member States on the production and circulation of audiovisual works. It was considered that national fiscal incentives could be an important factor in the development of co-productions, as well as the harmonisation of tax practices to avoid double liability. Producers and directors felt that the Commission should […] encourage Member States that don't have them to introduce fiscal measures to encourage audiovisual investment. A number of commentators referred to fiscal measures (in particular "tax shelters") that were being used to finance non-European production."

To date, the Commission has examined tax incentives adopted in a number of EU Member States, including notably France, Germany, the UK, Ireland, Belgium, the Netherlands and Luxembourg, as well as measures already in existence in certain new Member States, such as Malta and Hungary. Without going into detail concerning each one of these measures, it is important to stress the great diversity apparent in these measures with regard to several aspects, including their intended purposes, functioning, immediate beneficiaries, purposes, selection criteria or legal bases.

Fiscal incentives can notably take the form of reduced tax rates, tax shelters (Belgium), investment allowances (France), tax credits (France, the UK, Ireland), accelerated depreciation (France), etc. They may directly target audiovisual production companies (e.g. tax credits for film and audiovisual production in France, the new tax credit system in the UK). Alternatively, they may seek to encourage physical or moral persons to invest in audiovisual productions, regardless of their branch of activity, by allowing them to deduct a part of their investment from their income or corporation tax. This latter type of tax incentives, intervening before the production stage, includes the French SOFICA[32] scheme, the former "section 48" regime in the UK that supported "Sale and Leaseback" arrangements, as well as the former German *Medienfonds*.

Whereas most tax incentives are intended for pre-production and production stages by encouraging investments in productions or alleviating the production costs, other stages of the value chain may also be targeted. A notable example is the recent tax credit for the distribution costs of audiovisual programmes in France, introduced on 30 December 2006.[33] France has also a scheme under which certain cinemas are partially or totally exempted from professional tax.[34]

Finally, while tax incentive schemes simultaneously pursue economic and cultural aims, there are certain differences concerning which one of these factors is emphasised. Whereas strengthening the local audiovisual industry, promoting the country in question as a shooting location or avoiding delocalisation is a motivation for most of the European tax incentives, certain schemes have stricter criteria concerning the cultural value of the works they support, compared to others which have the clear aim of attracting foreign productions.

In this respect, it is interesting to note that when assessing the compatibility of fiscal State aid to the audiovisual sector with the EC Treaty, the Commission seems to pay increasing attention to the adequacy of the cultural tests used by these tax incentives. A notable example in this respect is the Commission's appraisal of the new UK tax credit scheme.[35] The cultural test for this tax credit, as initially proposed by the UK authorities, was rejected by the Commission. The scheme was only approved after the UK substantially amended the proposed cultural test, notably by increasing the points devoted to the cultural content section from 4 to 16 points out of a total of 31 points. Thus, the fact that the definition of the concept of a cultural product is left to the Member States under the subsidiarity principle does not imply that the margin of appreciation of the States is absolute and that the Commission will not exercise any control over the content of the works supported through such schemes.

B. EC VAT Rules and the Audiovisual Industry

As noted above, the EC Treaty provides for a much higher level of harmonisation of indirect taxation compared to direct taxation, due to the fact that indirect taxes may have much more immediate and tangible effects on the free movement of goods and the free supply of services within an Internal Market than direct taxes. Article 93 of the EC Treaty thus provides a legal basis for Community action regarding indirect taxes (see Chapter I.A. 1). Harmonisation measures adopted by the Council on the basis of this Article have typically taken the form of Council Directives.

This special treatment of indirect taxation has had a particularly significant effect on turnover taxes, one type being value added tax or VAT. Starting with the First and Second VAT Directives of 11 April 1967, EC legislation led to the replacement of alternative forms of turnover taxes by a common system of value added tax. This initial harmonisation has been pursued with a series of "numbered" Directives, the most important of which was the so-called Sixth VAT Directive,[36] which remained the cornerstone of Community VAT legislation until 1 January 2007. On this date, it was replaced by a new Directive on the common system of value added tax[37] (hereinafter the VAT Directive), which recasts and codifies the Sixth VAT Directive without changing the substance of the previously existing legislation.

As a result, the European framework in the field of indirect taxes, and notably VAT, can be considered an exception to the general rule of national fiscal sovereignty. The important body of EC VAT legislation considerably limits the margin of manoeuvre of Member States as regards turnover taxes: Member States are bound to levy VAT, to the exclusion of other forms of turnover tax, within a certain bracket of tax rates, in order to achieve a Community-wide "level playing field". In addition, in the framework of the passage to the single market, the Ecofin Council adopted in 1991 the Directive 91/680/EEC on the abolition of fiscal frontiers,[38] which establishes the general rule that private individuals shall be taxed exclusively in the country of purchase (with the notable exception of distance sales, see below).

The body of Community VAT rules has a real impact on the way in which VAT is collected in Member States and, thus, has important consequences for virtually all sectors of economic activity in Europe, including the audiovisual sector. This must also be considered in the context of the worldwide trend of a general shift from direct to indirect taxes, and the increasing share of VAT in State budgets.[39]

However, it is important to stress that the harmonisation at the EU level is far from being complete and that important discrepancies exist between Member States regarding the way in which VAT is applied. The States are notably free to choose the rates to be applied, provided that they are above the minimum rates defined in the VAT Directive. In addition, there is a wide array of exceptions, including special arrangements, options, temporary and transitional derogations (which are often not repealed), over 130 derogations authorised by the Council itself,[40] differences in the application of rules (e.g. concerning the determination of the place at which a transaction should be taxed), as well as shortcomings in the transposition of the VAT Directives.

The ensuing lack of transparency and legal uncertainty has motivated the Commission to publish a Paper in 1996, detailing the perceived shortcomings of the current European VAT system and a work programme for a system, which would be better suited to the needs of a Single Market. The proposed system would essentially result in the functioning of the Single Market as a domestic market for VAT purposes, which would require further harmonisation, notably with respect to the VAT rates, as well as the modernisation of the existing system, including aspects of administration, control, collection and co-operation between various tax authorities. However, the Commission's initiative has so far not been successful, owing to the reticence of Member States to further limit their fiscal sovereignty.

As regards the audiovisual industry and the Community VAT legislation, one of the main concerns involves, arguably, the possibilities offered by the existing rules to apply reduced VAT rates to audiovisual goods and services (1). Another question of particular relevance for the sector relates to the rules concerning the determination of the place of supply for VAT purposes (2).

1) VAT Rates

By applying reduced VAT rates, states can indirectly promote the audiovisual industry: the lower tax burden on the supplies at the final consumer level normally leads to lower end prices. This, in turn, leads to a higher consumption of the relevant supplies, given the price elasticity of demand.

In its Articles 93 to 130, the new VAT Directive provides a legal framework for the application of VAT rates in Member States. The basic rule is that the supplies of goods and services subject to VAT are normally subject to a standard rate. Member States are free to choose this rate, but it must be at least 15%. In practice, the standard rates applied in Member States vary widely, ranging from the minimum of 15% in Cyprus and Luxembourg, upwards to 25% in Sweden and Denmark.

The current legislation provides that Member States shall completely exempt certain supplies from VAT. Of relevance to the audiovisual sector in this respect are the following supplies:

> "the supply of certain cultural services, and the supply of goods closely linked thereto, by bodies governed by public law or by other cultural bodies recognised by the Member States concerned;
> the activities, other than those of a commercial nature, carried out by public radio and television bodies."[41]

Additionally, Articles 98-99 of the recast VAT Directive authorises Member States to apply one or two reduced rates of not less than 5%. These rates can however only apply to supplies of goods and services enumerated in a restrictive list, set out under Annex III of the Directive (formerly Annex H of the Sixth VAT Directive). Of particular relevance to the audiovisual sector are the following categories included in this list:

> " 7. admission to […] cinemas, exhibitions and similar cultural events and facilities;
> 8. reception of radio and television broadcasting services;
> 9. supplies of services of writers, composers and performing artists, or of the royalties due to them."

Thus, the leeway provided by the VAT Directive is such that the Member States are free to choose whether or not they wish to apply reduced rates, and if so, to select the categories to which the reduced rate(s) shall apply. Member States have made wide use of the possibilities offered within this framework, and the resulting situation is disparate and complex, with considerable variations between States. The rules are further complicated by numerous derogations granted to certain Member States, and in some cases to a group or even the majority of Member States. These derogations were notably granted during the negotiations preceding the adoption of the VAT rates Directive of 1992[42] and in the Acts of Accession to the European Union. According to the Commission, such derogations prevent a coherent system of VAT rates in the EU from being applied.[43]

The situation is further complicated by the special rules that apply to electronically supplied services. With the adoption of the so-called "e-commerce VAT" Directive,[44] the Sixth VAT Directive was amended to the effect that electronically supplied services can only be subject to standard VAT rates. Furthermore, the Directive contained no definition of "electronically supplied services", but simply referred to its Annex L, which contained a non-exhaustive list of electronically supplied services (Annex L became Annex II of the new VAT Directive).

The ensuing legal uncertainty was such that the clarification of the scope of this concept was one of the main components of the first interpretative Regulation[45] regarding the Sixth VAT Directive. The regulation notably includes, under electronically supplied services, the accessing or downloading of music, films and on-line video games. This would entail that such services, such as VoD services, would not qualify for reduced rates and would be subject to standard rates. However, radio and broadcasting services, as well as the supply of video cassettes and DVDs and games on a CD-ROM, even when the exchange takes place on the Internet, are not considered electronically supplied services for the purposes of the Directive.[46]

One could presume, therefore, that IPTV services could be subject to reduced rates if a Member State so decides.

The current state of EC VAT legislation relating to the audiovisual sector is, hence, very complex and creates considerable distortions. Not only do the VAT rates applied to audiovisual products and services differ widely among Member States, but the taxation of different media windows within the same Member State is also necessarily very different. For example, the VAT Directive allows States to apply reduced rates to cinema admissions, as well as television broadcasting services (including those delivered via the Internet), while exempting non-commercial services of public service broadcasters from VAT altogether. At the same time only standard VAT rates apply to CDs, videos and DVDs, as well as VoD. Thus the same audiovisual product is subject to very different levels of taxation depending on the method of delivery, penalising mainly the "new" exploitation windows. The distorting effect of this state of affairs for the audiovisual sector is evident.

Table of VAT Rates applicable to Audiovisual Goods and Services in EU Member States[47] (in percentage)

	Standard Rate	Reduced Rate	Cinema Admissions	Pay TV/ Cable TV	TV License	Video-DVD
AT	20	10	10	10	10	20
BE	21	6	6	12/21	-	21
BG	20	7	20	20	20	20
CY	15	5/8	15	15	15	15
CZ	19	5	5	ex/19	ex/19	19
DE	19	7	7	19	ex	19
DK	25	-	25	25	25	25
EE	18	5	5	18	18	18
EL	19	9	4.5	9	ex	19
ES	16	7	7	16	16	16
FI	22	8/17	8	22	8	22
FR	19.6	5.5	5.5	5.5	2.1	19.6
HU	20	5	20	ex/20	ex/20	20
IE	21	13.5	13.5	21	ex	21
IT	20	10	10	10	4	20
LT	18	5/9	5	18	18	18
LU	15	6	3	3/15	ex	15
LV	18	5	5	5	-	18
MT	18	5	18	18	18	18
NL	19	6	6	19	ex	19
PL	22	7	7	7/22	22	22
PT	21	5/12	5	21	21	21
RO	19	9	9	19	19	19
SE	28	6/12	6	25	ex	25
SI	20	8.5	8.5	20	ex/20	20
SK	19	10	19	ex/19	ex/19	19
UK	17.5	5	17.5	17.5	ex	17.5

The Commission acknowledged in its Cinema Communication that there is a general desire within the audiovisual sector, as well as among certain Member States, to address this problem:

> "The Commission notes the views expressed about taxation for cultural goods and services, and in particular the request to enable those Member States who wish to do so to apply a reduced rate of VAT to all cultural goods and services without discriminating between different forms of distribution. The Commission will consider whether to respond to this request in the context of the review of Annex H of the 6th VAT Directive, which will take place after 2002. The Commission would draw attention to the existing possibility for Member States to apply a reduced rate to cinema admissions."[48]

However, this has so far failed to produce a concrete result, despite the initiatives of some Member States, as any modification of Annex III would require unanimity within the Council.

2) Place of supply

The definition of the place of taxable transactions, which involve more than one Member State or a Member State and a non-EU country, is an important component of EC VAT legislation. This affects, notably, the rates applicable to the transaction in question, the administrative procedures involved, as well as the beneficiary State of the tax in question.

The rules concerning the definition of the place of taxable transactions are particularly complex and the new VAT Directive devotes no less than 31 Articles to this question (Title V, Articles 31-61), with numerous exceptions to the general rules. The place of a taxable transaction thus depends on many factors and varies according to whether the supply concerns goods or services, to whether it is an intra-Community supply, to the volume of the exchange, to the types of goods and services, etc.

Of particular relevance to the audiovisual industry is the question of the place of supply of audiovisual services. The general rule for services is that for VAT purposes, the place of supply is deemed to be the place "where the supplier has established his business or has a fixed establishment from which the service is supplied, or, in the absence of such a place of business or fixed establishment, the place where he has his permanent address or usually resides".[49]

However, a special set of rules applies to broadcasting and electronically supplied audiovisual services. These arrangements were first introduced by the so called "e-commerce VAT" Directive,[50] temporarily amending the Sixth VAT Directive. Under these special rules, the place of supply for radio and television broadcasting services and certain electronically supplied services (notably including accessing and downloading of films) is considered to be where the customer is located. On 19 December 2006, the Council of the European Union adopted the Council Directive 2006/138/EC, extending the period of application of these VAT arrangements until 31 December 2008.

The main objective of these arrangements is to rectify certain shortcomings of the VAT Directive. The provisions prior to 2002, in addition to failing to tax electronic services provided by third country operators to EU customers, imposed taxes on services provided by European operators regardless of where their customers were located. This state of affairs put European operators at a competitive disadvantage vis-à-vis non-EU service providers (for example, US companies were exempt of sales tax on their exports).

The Council Directive 2002/38/EC also includes simplified registration and reporting obligations to assist compliance by non-EU operators, allowing them to deal with a single European tax administration of their choice. This allows non-EU businesses to register with the VAT authorities of a single EU country and apply the VAT rates applicable in that country, rather than having to apply 27 different VAT rates in their invoices depending on the place of residence of their customers.

In this context, it is important to note that the EC VAT legislation provides for a framework in which undertakings that are established in one Member State but which incur VAT in another Member State may reclaim VAT charged in the second State.[51] However, this usually involves a complex administrative process and a considerable amount of time, depending on the Member State. The Thirteenth VAT Directive allows for a similar mechanism for non-EU businesses to recover VAT incurred in the EU, under certain circumstances.[52]

C. Direct Taxes - Cross-border Remuneration and Double Taxation

As discussed above, the distortive effects of direct taxes on intra-Community movement are less conspicuous than those of indirect taxes. Direct taxes may nonetheless affect important decisions concerning investment, establishment or employment. Substantial differences in the tax burden, and in particular an excessive tax burden due to double taxation as a result of economic activities crossing intra-Community borders, may considerably frustrate the free movement of labour and capital. In addition, the administrative burden of having to comply with 27 different tax legislations makes it difficult for European undertakings, and in particular for SMEs (small and medium-sized enterprises), to take full advantage of the Internal Market.

Concerning direct tax matters, the question of double taxation is the most relevant issue for the audiovisual sector. It is a common occurrence, especially with the achievement of the Internal Market, for an undertaking or physical person, resident in one Member State, to make a taxable gain in another Member State. Double taxation arises when the same gain is taxed locally in the Member State on the territory in which it arises, as well as by the Member State where the legal or physical person concerned is resident. This puts the taxpayer who has an economic activity in another Member State at a distinct disadvantage compared to a taxpayer whose activity does not cross the border.

The generating factor of double taxation is the fact that, for direct tax purposes, most EU Member States apply two criteria simultaneously: direct taxes are applied both according to the residence principle (unlimited tax liability of residents on their world-wide income) and the source principle (limited tax liability for gains arising on the State's territory, including the application of "withholding taxes" on payments to another party established abroad). In the absence of EC rules clearly preventing double taxation, Member States are indeed free to apply these seemingly inconsistent principles simultaneously.

This may concern the taxation of cross-border employment, dividend or interest payments (including intra-group transfers), but also the cross-border remuneration of intellectual property, which is particularly relevant for the audiovisual industry. In practice, the double taxation of cross-border royalty payments may occur when royalties arise in a state other than the state of residence (home state) of the rightsholder. A tax may be withheld by the source state, e.g. as a percentage of the royalty payment, whereas the payment will be taxed again as income for the rightsholder by the home state, in the framework of income or corporation tax.

Double taxation can be avoided when two states agree to completely abolish withholding taxes on certain types of cross-border payments. Alternatively, the home state may remedy double taxation of its resident taxpayers by using two alternative methods: either it exempts foreign-source income from income tax (exemption method), or it allows the deduction from income tax of an amount equal to the tax already paid in the source state (credit method).[53] Regardless of the method selected, one has to bear in mind that even in situations where they exist, double taxation relief mechanisms often involve extremely cumbersome administrative formalities. In practice, the relevant procedures may last for years and result in significant cash-flow problems for the companies concerned.

Having established how double taxation in respect of direct taxes can be a problem for the audiovisual sector, one can then assess the impact of EC law on this issue. In order to do this, it is useful to examine the existing positive integration measures in this field, and in particular the Interest and Royalty Directive (1). However, given the limits of Community competence in this area, one also has to look at the principal source of law in this domain, i.e. bilateral or multilateral double taxation treaties and their status vis-à-vis Community law (2).

1) Relevant EC legislation

With respect to corporation tax and the double taxation of cross-border income flows, the existing EC legislation addresses this problem only to the extent that it affects groups of companies.

Firstly, the Parent-Subsidiary Directive[54] seeks to prevent two tax problems relating to the cross-border profit distributions paid out of after-tax profits by an EC subsidiary company to its EC parent company. On the one hand, it abolishes withholding taxes in the source state on payments of dividends between associated companies (Article 5). On the other hand, it prevents double taxation of parent companies in their home state on the profits of their subsidiaries. For this, the home state has the choice between the two methods provided for in the OECD Model Convention (see above), the exemption method and the credit method (Article 4).

Secondly, the Interest and Royalty Directive (the "I+R Directive"),[55] deals with cross-border interest and royalty payments between associated companies. This Directive, which was only adopted 12 years after the Commission's initial proposal, establishes in its Article 1, paragraph 1 the rule by which:

> "Interest or royalty payments arising in a Member State shall be exempt from any taxes imposed on those payments in that State, whether by deduction at source or by assessment, provided that the beneficial owner of the interest or royalties is a company of another Member State or a permanent establishment situated in another Member State of a company of a Member State."

However, Paragraph 7 of the same Article restricts this benefit to cases where the paying company is an associated company of the beneficial owner. The two companies are considered 'associated companies' when either one of them holds directly at least 25% of the capital or the voting rights in the other, or where a third EC company has that level of control of both (Article 3(b)).

While the I+R Directive represents an important step toward addressing double taxation of royalty payments, it does not resolve the question altogether. In addition to being only limited to transactions between associated companies, it is also subject to many derogations. Derogations regarding three Member States, Greece, Spain and Portugal, were codified from the start, "for budgetary reasons". In addition, a specific amending Directive extended certain derogations to five new Member States.[56] As regards royalties, the resulting situation is as follows:

- Slovakia was exempted from applying Article 1 until 1 May 2006;
- Greece, Latvia, Poland and Portugal may maintain a withholding tax of up to 10% until 1 July 2009 and 5% until 1 July 2011;
- Lithuania, Spain and the Czech Republic may maintain a withholding tax of up to 10% until 1 July 2011.

However, if any bilateral treaty between these and other Member States provides for a lower withholding tax for royalty payments, the lower rate shall be applied. After these dates, these States should, in principle, fully comply with the Directive, unless the derogations are extended.

As for the taxation of cross-border royalty payments between non-associated companies, in the present state of Community law, this matter is entirely left to bilateral arrangements between Member States.

2) Bilateral Tax Treaties

In the absence of Community competence in this area, apart from the specific cases examined in the previous section, the main source of international law relating to the question of double taxation remains the set of rules derived from bilateral or multilateral tax treaties, as transposed into domestic law.

However, in the EU of 27 Member States, a complete web of bilateral double taxation agreements would encompass 351 treaties, with possibly widely divergent sets of rules. In addition to the potentially distorting effects of uncoordinated bilateral tax arrangements, this represents a considerable administrative difficulty for legal and physical persons who exercise their freedoms of movement on the basis of the EC Treaty.

In this respect, the "OECD Model Convention with respect to Taxes on Income and on Capital" has been a mitigating factor, because it has served as a source of inspiration for many of the existing bilateral treaties. Concerning royalties, this Convention notably provides that "royalties arising in a Contracting State and beneficially owned by a resident of the other Contracting State shall be taxable only in that other State."[57] In practice, however, the concrete rules in bilateral treaties vary widely, owing to the fact that the Model Convention itself provides for a certain amount of leeway, and as several Member States formulated reservations with regard to the quoted Article for different reasons.[58]

The relationship between Community law and international tax treaty law is complex and has already given rise to a number of conflicts, which gave the ECJ the opportunity to clarify the status of tax treaties in EC law.

As noted above (see Chapter 1.A.2), Article 293 (2nd indent) of the EC Treaty provides that Member States shall enter into negotiations with each other with a view to abolishing double taxation within the Community. Significantly, however, the ECJ found that this provision has no direct effect:

> "Although the abolition of double taxation within the Community is thus included among the objectives of the Treaty, it is clear from the wording of that provision that it cannot itself confer on individuals any right on which they might be able to rely before their national courts."[59]

This means that the Member States fully retain their powers of taxation in this field and that they are not obliged to pursue the abolition of double taxation actively. While the Court recognises that double taxation may have negative effects on the functioning of the internal market, it considers these effects as resulting "from the exercise in parallel by two Member States of their fiscal sovereignty."[60]

However, in this context the ECJ makes a clear distinction between the *allocation of powers of taxation* and *the exercise of powers of taxation*, and subjects the latter to the respect of general principles of Community law. This situation has been very clearly presented by the Court in its *Saint-Gobain* judgment:

> "In the absence of unifying or harmonising measures adopted in the Community, in particular under the second indent of [Article 293 EC], the Member States remain competent to determine the criteria for taxation [...] with a view to eliminating double taxation by means, inter alia, of international agreements [...]

> As far as the exercise of the power of taxation so allocated is concerned, the Member States nevertheless may not disregard Community rules. According to the settled case-law of the Court, although direct taxation is a matter for the Member States, they must nevertheless exercise their taxation powers consistently with Community law."[61]

Accordingly, the Court has examined, on a number of occasions, the exercise of the power of taxation of Member States in relation to bilateral tax treaties, and declared certain practices incompatible with the EC Treaty. These notably include the following:

- When workers derive the major part of their income in a Member State where they are not resident, that Member State is obliged to extend its tax benefits to them.[62] This diverges from the OECD Model Convention principle, according to which it is the home state's obligation to take account of the personal and family circumstances of cross-border workers. In special situations, the home state is also required to take account of the tax burden in the source state in order to counterbalance the disadvantageous tax effects of cross-border situations, over and above the requirements of the OECD Model Convention.[63]
- With regard to permanent establishments of Community undertakings on their territory, Member States must grant the same tax benefits as they grant to resident companies. This unconditional right may not be limited by the effect of a tax treaty with another Member State,[64] despite the fact that currently most tax treaties limit their application to undertakings resident in the two Contracting States.
- The Court applies this principle to double-taxation treaties concluded with third countries, obliging Member States to extend the benefits thus negotiated to branches of resident companies of other Member States.[65]
- In general, bilateral tax treaties with Member States or third countries may not serve as a justification to curb rights conferred by EC law, including secondary legislation, such as the Parent-Subsidiary Directive. Regarding the exemption from withholding tax provided for in Article 7 of the Directive, the Court ruled that the rights conferred on economic operators by the Directive were unconditional and that a Member State could not make their observance subject to an agreement concluded with another Member State.[66] This has to be seen in conjunction with the fact that the Court has been very reluctant to admit public interest justifications in its case law for the restrictive tax treatment of cross-border situations (See I.B above).

However, Member States are free to choose their method of elimination of double taxation (exemption or credit),[67] as well as the criteria to determine the division of their taxing jurisdiction:

> "Member States are at liberty, in the framework of bilateral agreements concluded in order to prevent double taxation, to determine the connecting factors for the purposes of allocating powers of taxation as between themselves."[68]

It follows from the preceding considerations that, although double-taxation treaties are subject to some degree of Community control, in situations where there is no overt conflict with the general principles of EC law, the Member States have no explicit obligation to ensure that their bilateral treaties compensate for all possible forms of double taxation, including double taxation of cross-border royalty payments. At any rate, the EC law in its current status is silent about situations where no bilateral double-taxation treaty exists between two Member States, or where an existing treaty does not satisfactorily prevent double taxation in practice.

Conclusion

EC law has had a considerable influence on the evolution of the tax systems of EC Member States, and consequently on the development of the European audiovisual sector. However, this influence has been far from uniform and the relationship between EC law and national tax laws remains extremely complex. The three areas that were examined more closely demonstrate this point very clearly.

Thus, EC competition law, in so far as it controls State aid granted to the audiovisual sector in the form of fiscal incentives, demonstrates how an essentially non-fiscal policy area can have a limiting effect on national tax systems. This control has naturally been analogous to the control of more direct forms of aid and is likely to continue to be determined by the more general Community policy regarding the audiovisual sector, as expressed in the Commission's "Cinema Communication". In this respect, the outcome of the current consultation process regarding the effects of territorialisation clauses will be particularly important.[69]

As for VAT, one could conclude that the EC law has had two, possibly contradictory, effects on the audiovisual sector. On the positive side, it has eliminated important indirect tax barriers between Member States on audiovisual goods and services, and has favoured the support of audiovisual content by authorising Member States to apply reduced VAT rates to a limited number of audiovisual services. On the negative side, however, it continues to tolerate considerable differences in VAT rates applied by Member States, while at the same time removing their competence to extend VAT advantages to other, and in particular newer, exploitation windows, such as DVDs or VoD services. As any further change is subject to a unanimous decision of Member States, the capacity of the EC VAT legislation to adapt to the new realities of the audiovisual sector is severely limited, with the obvious risk that this may lead to certain distortions among the various branches of the audiovisual industry.

With respect to direct taxes, the current lack of a concerted effort at the EC level with a view to eliminating double taxation, in particular of cross-border royalty payments, appears as a clear disadvantage for the European audiovisual sector. The existing Directives provide solutions only to a very limited extent. Thus, bilateral treaties remain the principal source of law in the field, which creates a very complex legal situation involving national tax systems, international law and Community law. Even in cases where remedies are provided for, the opacity of the legal framework, the excessive administrative burdens, as well as severe cash-flow problems these might engender, could be particularly discouraging for smaller and medium-sized companies – a prevailing feature of the European audiovisual industry. Although the Commission is paying increasing attention to this question,[70] it is unlikely that these problems will be resolved in the immediate future, given the strict unanimity rule applying also to direct tax matters.

While acknowledging that EC law has had a non-negligible effect on the taxation of the audiovisual sector, one may conclude that, when it comes to fiscal matters, the Community is still far from providing the conditions necessary for a single European audiovisual market, comparable for instance to the US market. In this respect, the rule of unanimity concerning both indirect and direct taxes appears as the main obstacle to further integration. This is a situation that the European audiovisual sector will have to reckon with for the foreseeable future, given the general reluctance of Member States to accept further limitations to their fiscal sovereignty: it is telling that even the European Constitution, judged too revolutionary in some quarters, did not propose to change the rule of unanimity in tax matters.

1) Understood as the process of increasing the ability of different tax systems to function as a coherent whole, with a view to increasing the level of interaction between them.
2) B.J.M. Terra and P.J. Wattel, *European Tax Law*, Kluwer Law International, The Hague 2005, p. 9.
3) Case C-279/93 (*Schumacker*), judgment of 14 February 1995, ECR I-225, point 21.
4) The reluctance of the Member States to give up their power of veto in tax-related matters is demonstrated by the fact that fiscal provisions have been explicitly excluded from the legal basis provided by Article 95, which allows for a qualified majority vote for measures needed for establishing the internal market.
5) Council Directive 90/434/EEC of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States, OJ L 225 of 20 August 1990, p. 1. This Directive was substantially amended in 2005.
6) Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, OJ L 225 of 22 September 1990, p. 6. This Directive was amended in 2003.
7) Council Directive 2003/48/EC of 3 June 2003 on taxation of savings income in the form of interest payments, OJ L 157 of 26 June 2003, p. 38.
8) 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 of 26 June 2003, p. 49.
9) Council Regulation (EEC) No 2137/85 of 25 July 1985 on the European Economic Interest Grouping (EEIG), OJ L 199 of 31 July 1985, p. 1.
10) Convention 90/436/EEC on the elimination of double taxation in connection with the adjustment of transfers of profits between associated undertakings, OJ L 225 of 20 August 1990. See also the related Code of Conduct, OJ C 176 of 28 July 2006, p. 8. Note that as not all Member States have ratified the Protocol extending the Arbitration Convention, the Convention ceased to have effect in 2000, but was reactivated with retroactive effect in 2004. For more information on the complex legal situation concerning this Convention, see Commission Communication COM(2007)71 final (not published in the Official Journal).
11) Working document on EC Law and Tax Treaties:
http://ec.europa.eu/taxation_customs/resources/documents/taxation/personal_tax/double_tax_conventions/ECLawTaxTreaties_en.pdf
12) The Agreement on the European Economic Area extends to individuals and enterprises of EEA States (Iceland, Liechtenstein and Norway) the principles of free movement of goods, persons, services and capital, as well as of equal conditions of competition and non-discrimination. However, secondary EC legislation does not apply in these EEA States.
13) Case C-175/88 (*Biehl*), judgment of 08 May 1990, ECR I-1779, para. 13.
14) Case 18/84 (*Commission v. France*), judgment of 07 May 1985, ECR 1339. It is interesting to note that the same measure was also found incompatible with Article 87(1) regarding State aid.
15) See, for example, Case C-204/90 (*Bachmann*), judgment of 28 January 1992, ECR I-249; Case C-118/96 (*Safir*), judgment of 28 April 1998, ECR I-1897; Case C-136/00 (*Danner*), judgment of 3 October 2002, ECR I-8147.
16) Case C-324/00 (*Lankhorst-Hohorst GmbH v. Finanzamt Steinfurt*) of 12 December 2002, ECR I-11779, para. 32. This case concerned an obstacle to the freedom of establishment due to a differential treatment of subsidiaries according to the seat of the parent company.
17) Case C-55/94 *(Reinhard Gebhard v. Consiglio dell'Ordine degli Avvocati e Procuratori di Milano*), judgment of 30 November 1995, ECR I-4165, para. 37.
18) See Art. 30-34 and 36 EC for the free movement of goods, Art. 39, para. 3 EC for workers, Art. 46 EC for the freedom of establishment, Art. 55 EC for services and Art. 58, para. 1.b EC for capital and payments.
19) Case C-250/95 (*Futura Participations SA and Singer v. Administration des contributions*), judgment of 15.05.1997, ECR I-2471.
20) Case C-55/98 (*Vestergaard*), judgment of 28.10.1999, ECR I-7641, para. 25.
21) For example, Belgium in the *Bachmann* case, C-204/90, judgment of 28.01.1992, ECR I-249.
22) See, for example, the "Code of Conduct for Business Taxation":
http://ec.europa.eu/taxation_customs/taxation/company_tax/harmful_tax_practices/index_en.htm#state_aid
23) Art. 87(1) of the EC Treaty.
24) Art. 87(3)d of the EC Treaty.
25) Commission Decision 89/441/EEC of 21 December 1988 on aid granted by the Greek government to the film industry for the production of Greek films. OJ L 208 of 20 July 1989, p. 38-41.
26) Communication from the Commission to the Council, the European Parliament, the Economic and Social Committee and the Committee of the Regions on the follow-up of the Commission communication on certain legal aspects relating to cinematographic and other audiovisual works of 26 September 2001, OJ C 123, 30 April 2004, p. 1.
27) http://eur-lex.europa.eu/LexUriServ/site/en/oj/2007/c_134/c_13420070616en00050005.pdf
28) Commission Notice on the application of the State aid rules to measures relating to direct business taxation, OJ C 384 of 10 December 1998, p. 3-9.
29) See, for example, ECJ judgment of 12 July 1973, Case 70/72 (*Commission v. Germany*), ECR 813. This case concerned aid in the form of a reduction of taxation making certain investments attractive in order to improve the economic structure of the German regions affected by the coal crisis.
30) Wolfgang Schön, "Taxation and State Aid Law in the European Union", 1999, *Common Market Law Review*, p. 911-936.
31) European Commission, State aid Scoreboard, Autumn 2006 update: COM (2006) 761 final, 11 December 2006, p. 27.
http://ec.europa.eu/comm/competition/state_aid/studies_reports/2006_autumn_en.pdf
32) Articles 199 unvicies, 217 septies, 238 bis HE to HM of the *Code Général des Impôts* (French Tax Code), and Articles 46 quindecies A to F of its Appendix III. See, H. Bermek, "Tax incentives for films and audiovisual works in France", 2007.
http://www.obs.coe.int/online_publication/reports/tax_incentives_films_france.pdf
33) Ibid.; Article 220 duodecies of the *Code Général des Impôts*.
34) Article 1464 A of the *Code Général des Impôts*.
35) Commission Decision of 22 November 2006, "State aid N 461/2005 – United Kingdom, UK Film Tax Incentive", C(2006)3982 final
http://ec.europa.eu/community_law/state_aids/comp-2005/n461-05.pdf
36) Sixth Council Directive 77/388/EEC of 17 May 1977, OJ L 145 of 13 June 1977, p.1.
37) Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, OJ L 347 of 11 December 2006, p. 1.
38) Council Directive 91/680/EEC of 16 December 1991, OJ L 376 of 31 December 1991, p.1.
39) Cf. OECD, Consumption Tax Trends, 2006 edition, OECD Publishing, 16 June 2006.
40) Terra and Wattel, European Tax Law, p. 225.
41) Council Directive 2006/112/EC, Art. 132, para. 1, sub-para. n and q.
42) Council Directive 92/77/EEC of 19 October 1992 supplementing the common system of value added tax and amending Directive 77/388/EEC (approximation of VAT rates), OJ L 316 of 31 October 1992, p. 1.
43) http://ec.europa.eu/taxation_customs/taxation/vat/how_vat_works/rates/index_en.htm
44) The Council Directive 2002/38/EC of 7 May 2002 amending and amending temporarily Directive 77/388/EEC as regards the value added tax arrangements applicable to radio and television broadcasting services and certain electronically supplied services, OJ L 128 of 15 May 2005, p.41.
45) Council Regulation (EC) No 1777/2005 of 17 October 2005 laying down implementing measures for Directive 77/188/EEC on the common system of value added tax, OJ L 288 of 29 October 2005 p.1. This Regulation was adopted on the basis of Article 29(a) of the Sixth VAT Directive (now Article 397). First introduced on 9 February 2004, this Article provides that "the Council, acting unanimously on a proposal from the Commission, shall adopt the measures necessary to implement this Directive".
46) This, however, does not affect the situation of video cassettes and DVDs, given that Member States are at any rate obliged to apply standard VAT rates to these products, because they are not included under Annex III of the VAT Directive.
47) Data source: Commission Document, DOC/2137/2007, "VAT Rates Applied in the Member States of the European Community", Situation at 1st May 2007.
http://ec.europa.eu/taxation_customs/resources/documents/taxation/vat/how_vat_works/rates/vat_rates_en.pdf
48) Point 5 of the "Cinema Communication", see note 26.
49) Council Directive 2006/112/EC, Art. 43.
50) See note 44.
51) The so-called "Eighth VAT Directive", Council Directive 79/1072/EEC of 6 December 1979 on the harmonization of the laws of the Member States relating to turnover taxes - Arrangements for the refund of value added tax to taxable persons not established in the territory of the country, OJ L 331 of 27 December 1979, p. 11.
52) Thirteenth Council Directive 86/560/EEC of 17 November 1986 on the harmonization of the laws of the Member States relating to turnover taxes - Arrangements for the refund of value added tax to taxable persons not established in Community territory, OJ L 326 , 21 November 1986, p. 40.
53) Cf. Articles 23A and 23B of the OECD Model Convention with respect to Taxes on Income and on Capital, OECD Publishing, 21 September 2007,
http://www.oecd.org/dataoecd/50/49/35363840.pdf
54) See note 6.
55) See note 8.
56) Council Directive 2004/76/EC of 29 April 2004 amending Directive 2003/49/EC as regards the possibility for certain Member States to apply transitional periods for the application of a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States, OJ L 157 of 30 April 2004, p. 106.
http://eur-lex.europa.eu/LexUriServ/site/en/oj/2004/l_157/l_15720040430en01060113.pdf
57) Article 12, paragraph 1 of the OECD Model Convention with respect to Taxes on Income and on Capital, OECD Publishing, 21 September 2007.
58) Belgium, the Czech Republic, France, Greece, Hungary, Italy, Poland, Portugal, the Slovak Republic, Spain. ibid., see in particular the "Commentary on Article 12 concerning the Taxation of Royalties".
59) Case C-336/96 (*Gilly*), judgment of 12 May 1998, ECR I-2793, point 16.
60) Case C-513/04 (*Kerckhaert and Morres*), judgment of 14 November 2006, ECR I-10967, point 20.
61) Case C-307/97 (*Saint-Gobain ZN*), judgment of 21 September 1999, ECR I-6161, points 56 and 57 (Words not underlined in the original).
62) Case C-279/93 (*Schumacker*), judgment of 14 February 1995, ECR I-0225.
63) Case C-385/00 (*de Groot*), judgment of 12 December 2002, ECR I-18819, point 115: "Community law contains no specific requirement with regard to the way in which the State of residence must take into account the personal and family circumstances of a worker who, during a particular tax year, received income in that State and in another Member State, except that the conditions governing the way in which the State of residence takes those circumstances into account must not constitute discrimination, either direct or indirect, on grounds of nationality, or an obstacle to the exercise of a fundamental freedom guaranteed by the Treaty."
64) The "*Avoir Fiscal*" case, Case 270/83 (*Commission v France*), judgment of 28 January 1986, ECR 273, point 26.
65) Case C-307/97 (*Saint-Gobain ZN*), judgment of 21 September 1999, ECR I-6161, point 58. The two double-taxation treaties in question were those concluded by Germany with the USA and Switzerland.
66) Case C-294/99 (*Athinaïki Zythopolia*), judgment of 4 October 1999, ECR I-6797, point 32.
67) Case C-336/96 (*Gilly*), judgment of 12 May 1998, ECR I-2793.
68) Case C-307/97 (*Saint-Gobain ZN*), judgment of 21 September 1999, ECR I-6161, point 56.
69) http://www.eufilmstudy.eu
70) See, for example, the workshop organised by the Commission in July 2005 on "EC Law and Tax Treaties":
http://ec.europa.eu/taxation_customs/taxation/company_tax/double_taxation_conventions/workshop/index_en.htm

Principal Legal Texts

Competition Law

Primary EC Law:

Article 87 of the EC Treaty

"1. Save as otherwise provided in this Treaty, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the common market.

3. The following may be considered to be compatible with the common market:

[…]

(d) aid to promote culture and heritage conservation where such aid does not affect trading conditions and competition in the Community to an extent that is contrary to the common interest;"

Article 88 of the EC Treaty

"1. The Commission shall, in cooperation with Member States, keep under constant review all systems of aid existing in those States. […]

2. If, after giving notice to the parties concerned to submit their comments, the Commission finds that aid granted by a State or through State resources is not compatible with the common market having regard to Article 87, or that such aid is being misused, it shall decide that the State concerned shall abolish or alter such aid within a period of time to be determined by the Commission. […]

3. The Commission shall be informed, in sufficient time to enable it to submit its comments, of any plans to grant or alter aid. If it considers that any such plan is not compatible with the common market having regard to Article 87, it shall without delay initiate the procedure provided for in paragraph 2. The Member State concerned shall not put its proposed measures into effect until this procedure has resulted in a final decision."

Communications from the Commission:

Communication from the Commission to the Council, the European Parliament, the Economic and Social Committee and the Committee of the Regions on the follow-up of the Commission communication on certain legal aspects relating to cinematographic and other audiovisual works of 26 September 2001, OJ C 123, 30 April 2004, p. 1.
http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52001DC0534:EN:NOT

Commission Notice on the application of the State aid rules to measures relating to direct business taxation, OJ C 384 of 10 December 1998, p. 3-9.
http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31998Y1210(01):EN:HTML

Indirect taxation

Primary EC Law:

Article 93 of the EC Treaty

"The Council shall, acting unanimously on a proposal from the Commission and after consulting the European Parliament and the Economic and Social Committee, adopt provisions for the harmonization of legislation concerning turnover taxes, excise duties and other forms of indirect taxation to the extent that such harmonisation is necessary to ensure the establishment and the functioning of the internal market within the time limit laid down in Article 14."

Secondary EC Law:

Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, OJ L 347 of 11 December 2006, p. 1.
http://eur-lex.europa.eu/LexUriServ/site/en/oj/2006/l_347/l_34720061211en00010118.pdf

Council Directive 2002/38/EC of 7 May 2002 amending and amending temporarily Directive 77/388/EEC as regards the value added tax arrangements applicable to radio and television broadcasting services and certain electronically supplied services, OJ L 128 of 15 May 2005, p.41.
http://eur-lex.europa.eu/LexUriServ/site/en/oj/2002/l_128/l_12820020515en00410044.pdf

Council Regulation (EC) No 1777/2005 of 17 October 2005 laying down implementing measures for Directive 77/188/EEC on the common system of value added tax, OJ L 288 of 29 October 2005 p.1.
http://www.revenue.ie/publications/legisltn/ec_council_reg_1777_2005.pdf

Direct Taxation

International Law:

OECD Model Convention with respect to Taxes on Income and on Capital:
http://www.oecd.org/dataoecd/50/49/35363840.pdf

Primary EC Law:

Article 94 of the EC Treaty

"The Council shall, acting unanimously on a proposal from the Commission and after consulting the European Parliament and the Economic and Social Committee, issue directives for the approximation of such laws, regulations or administrative provisions of the Member States as directly affect the establishment or functioning of the common market."

Article 293 of the EC Treaty

"Member States shall, so far as is necessary, enter into negotiations with each other with a view to securing for the benefit of their nationals: […]

- the abolition of double taxation within the Community."

Secondary EC Law:

Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, OJ L 225 of 22 September 1990, p. 6. (Consolidated version)
http://eur-lex.europa.eu/LexUriServ/site/en/consleg/1990/L/01990L0435-20070101-en.pdf

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 of 26 June 2003, p. 49.
http://eur-lex.europa.eu/LexUriServ/site/en/oj/2003/l_157/l_15720030626en00490054.pdf

EC Arbitration Convention:

Convention 90/436/EEC on the elimination of double taxation in connection with the adjustment of transfers of profits between associated undertakings, OJ L 225 of 20 August 1990.
http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:41990A0436:en:NOT