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Re: Tax Foundation Europe's feedback to Proposal for a directive - COM(2026)560

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Introduction

Tax Foundation Europe's mission is to develop research and educate policymakers on tax matters that impact the growth and competitiveness of the European Union's economy. Accordingly, our input to the European Commission's public consultations on the Tax Omnibus proposal (the "Proposal") is not comprehensive but a review of selected issues that have an impact on growth and competitiveness. We hope to contribute meaningfully to the discussions currently happening at the Council.

The first issue we address is the elimination of the holding requirement from the Parent-Subsidiary (PSD) and Interest and Royalty (IRD) directives to benefit from the exemption from withholding taxes on dividend, interest, and royalty payments. The second is the nature of the Anti-Tax Avoidance Directive (ATAD) as a minimum standard of protection of Member States' tax bases or minimum harmonization.

1. PSD and IRD's Elimination of the Holding Requirement

The PSD and IRD have slightly different requirements for the equity, debt, and intellectual property (IP) rights holder to benefit from the exemption from withholding tax on the dividend, interest, and royalty payment. Among other requirements, the PSD requires the parent company to hold at least 10 percent of the shares of the subsidiary (directly or indirectly), whereas the IRD requires that associated companies be connected by at least 25 percent of shareholding directly or via a common parent. Below these thresholds and subject to the EU Treaties, Member States remain free to levy a withholding tax on the relevant cross-border payment. The Proposal would abolish those thresholds, meaning that Member States would no longer be free to levy withholding taxes on cross-border payments to so-called portfolio investments (i.e., below 10 percent and 25 percent).

Member States have argued that the amendment would shift the PSD and IRD from facilitating the grouping of companies within the EU toward reallocating taxing rights among Member States. Because that reallocation would affect national tax revenues differently, the Proposal could have asymmetrical fiscal effects across Member States.

We first examine the changing nature of the PSD and IRD and whether the avoidance of double taxation is equally justified for controlling and portfolio investments. We then assess the Proposal's potential impact on Member States' tax revenues and suggest alternatives that could address budgetary concerns while preserving the Proposal's competitiveness objective.

1.1. Definitive Double Taxation on Portfolio Investments Despite EU Court of Justice's Case-Law and Double Tax Conventions

As mentioned in the previous section, for the shareholdings not covered by the directives, Member States remain free to levy a withholding tax on outbound payments of dividends, interest, and royalties.

For dividend income, this might cause triple taxation. First, the distributing company's profits are taxed with a corporate income tax in its state of residence. Second, the receiving company is taxed by the state of the distributing company on the amount of dividends distributed. Third, the receiving company is again taxed in its state of residence, as the dividends received enter its tax base for corporate income tax purposes.

For interest and royalty income, there might be double taxation. First, the interest and royalties received by the receiving company are taxed via withholding tax by the paying company's state. Second, the interest and royalties received by the receiving company are taxed in its state of residence as the interest and royalties enter its tax base for corporate income purposes.

1.1.1. Limits Imposed by the EU Fundamental Freedoms

EU law sets a limit to this power, as it requires Member States to treat resident and non-resident taxpayers in the same way when they are in a comparable situation.

Broadly, for dividends, this means that Member States cannot levy a withholding tax on all dividend payments (within and outside their territory) and grant an exemption or credit to their recipient only when a resident.[1] In the simplest scenario possible, a Member State that exempts all dividends received by domestic companies from their domestic subsidiaries from corporate income tax cannot simultaneously levy a withholding tax on dividends paid abroad.[2]

For interest and royalties, granting national treatment to non-residents mostly means that source Member States levying a withholding tax may have to take into account the expenses connected to that income in the source state—as it would do for its own residents[3]—and tax that item of income on a net basis.[4] On the other end of the payment, a Member State would typically subject any received interest and royalty payment to tax, regardless of their source being domestic or not, meaning that equal treatment would not help solve the juridical double taxation outcome.[5]

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[1] That is, unless it has a double tax treaty with the state of the recipient company that would fully offset the higher liability incurred by that receiving company in the state of the distributing company (Joined Cases C-10/14, C-14/14 and C-17/14, *Miljoen*). However, this requires the creditable amount to coincide with the tax levied in the source state, and the taxpayer not to be in a loss position. See Ivan Lazarov, "Case Law Trend: Withholding Taxation Under the Fundamental Freedom," *Intertax* 51:6 (2023).

[2] Correspondingly, a Member State that applies a method to eliminate double taxation of dividends received by a resident company by a domestic subsidiary must allow the same when the dividends are received by subsidiaries in other EU Member States. Case C-319/02, *Manninen*. For an overview of the case-law, see, for instance, European Parliament, Directorate-General for Internal Policies, "The impact of the rulings of the European Court of Justice in the area of direct taxation 2010," (2011), https://www.europarl.europa.eu/document/activities/cont/201203/20120313ATT40640/20120313ATT40640EN.pdf.

[3] This also applies to outbound dividend withholding taxes. See Joined Cases C-10/14, C-14/14 and C-17/14, *Miljoen*.

[4] Case C-18/15, *Brisal*.

[5] On juridical double taxation, the landmark case is Case C-513/04, *Kerckhaert and Morres*. In the literature, Georg Kofler and Ruth Mason, "Double Taxation: A European 'Switch In Time?'" *Columbia Journal of European Law* (2007), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=979750.

This summary shows that EU fundamental freedoms constrain outbound withholding taxes more strictly for dividends than for interest and royalties. For dividends, Member States' room for manoeuvre is narrower; for interest and royalties, it is broader. The distinction arises because dividends are distributions of after-tax profits, usually exempted upon receipt, whereas interest and royalty payments are generally deductible expenses for the paying company and income for the recipient.[6]

1.1.2. Limits Imposed by Double Tax Conventions

The double tax conventions (DTCs) entered into by the Member States among each other also limit the Member States' power to levy withholding taxes on outbound payments. Typically, these DTCs (i) limit the rate of withholding tax that the state of the paying company can levy,[7] and (ii) oblige the state of residence of the receiving company to grant credit for the withholding tax paid abroad.[8]

However, despite the constraints imposed by EU law and DTCs on Member States, there can be instances of definitive double taxation within the internal market. To the extent that source states treat resident and non-resident taxpayers the same, Member States can levy EU law-compliant withholding taxes on dividend, interest, and royalty payments. Double tax treaties may not come to the rescue.[9] In fact, there are instances that DTCs cannot solve, such as triangular or multi-country cases,[10] as well as divergent interpretations of treaty terms by treaty partners. This may lead to instances of definitive double taxation within the Union.

1.2. Even When Credited, Withholding Tax Refunds' Administrative Costs Deter Free Movement

For portfolio investments, there is no clear empirical evidence that the existence of (definitive) withholding taxes per se influences the investment location decision. However, as domestic, EU law or DTC-based exemptions from withholding taxes come with administrative requirements, often Member States levy their (higher) statutory withholding tax instead of the lower (treaty) rate, pending the verification of these requirements. Refunds of the difference come with a time lag. Administrative costs and time lags have been proven to be negatively correlated with investment decisions.[11] In other words, the higher the

[6] This differentiation assumes that there is a clear difference between dividends and interest. However, real-world cases are much more complex, as there are dividends with interest-like features and interest with dividend-like features. See Wolfgang Schön, "International Tax Coordination for a Second-Best World (Part II)," *World Tax Journal*, *IBFD* (2010).
[7] As per the OECD Model Convention, source states can levy a withholding tax on dividend income from portfolio investment at the rate of 15 percent and interest at 10 percent, while they would have to exempt royalties altogether. However, Member States can and do deviate from such model rules in their concrete treaty practice.
[8] Double tax conventions do not oblige the state of residence of the receiving company to grant a credit or an exemption for the corporate income tax paid by the distributing company on its profits, before distribution.
[9] As explained above, for dividend payments, the extent to which double taxation can remain within the EU is much smaller, as the Member State of the receiving company would have to relieve the recipient company in the same way that a company receiving domestic dividends is (*Manninen*).
[10] Triangular situations occur, for instance, if a company is a dual resident and receives income from sources in a third state, or if a company resident in one state receives income from another state that is attributable to a permanent establishment (PE) in a third state. The key issue arising from these situations is that the PE state is not required to apply the conditions of the treaty it has in force with the source state, as the PE is not entitled to treaty benefits in the PE state. See Emily Fett, *Triangular Cases: The Application of Bilateral Income Tax Treaties in Multilateral Situations*, IBFD, Doctoral Series (2014).
[11] Serena Fatica, Jonathan Pycroft, Andrzej Stasio, and Daniel Stöhlker, "Economic Effects of Simplified Procedures for Claiming Cross-Border Tax Reliefs," *Nordic Tax Journal* (2024), https://doi.org/10.2478/ntaxj-2024-0007.

recovery costs of (over)withheld taxes,[12] the lower the investments in a given jurisdiction, potentially affecting the functioning of the internal market.

1.3. No Convincing Case to Limit the Exemption to Controlling Shareholdings

The exemption from the application of withholding taxes on outbound payments is currently limited to so-called "direct shareholdings," i.e., above 10 percent in the PSD and 25 percent in the IRD. Originally, before dropping to 10 percent, the PSD also had a 25 percent shareholding requirement.[13] Scholars have explained that if 25 percent could loosely mimic substantial minority rights under the corporate laws of several Member States, 10 percent looks like an arbitrary threshold to benefit from the avoidance of double taxation.[14]

Besides, the more beneficial treatment of direct holdings compared to portfolio holdings does not seem convincing enough. The OECD Commentary to Article 10 of the OECD Model Convention, which also grants more beneficial treatment to direct holdings (above 25 percent), explains that the reason behind such different treatment is to avoid recurrent taxation and facilitate international investment. However, this may well apply to both direct and portfolio investments.[15] A dividend or an interest payment is taxed twice, once by the paying company's state via withholding tax and once by the receiving company's state via corporate income tax, regardless of the percentage of investment.[16]

A more convincing argument concerns neutrality between establishing a subsidiary and operating through a permanent establishment (PE) abroad. Because a permanent establishment is part of the same legal entity as its head office, transfers between them do not constitute dividend distributions and are therefore not subject to dividend withholding tax. If dividends distributed by a subsidiary were subject to withholding tax, businesses could have a tax incentive to choose a permanent establishment instead. Exempting direct holdings from withholding tax therefore helps preserve neutrality between the two legal forms.[17]

However, granting exemption to portfolio investments as well would not defeat that goal.[18] By exempting *all* dividend payments from withholding taxes, PEs and subsidiaries would still be treated equally, *and* portfolio investors would not be subject to a double layer of taxation.

1.4. Asymmetrical Revenue Impact on the Member States

The Proposal's fiscal impact would differ across Member States according to whether, and on which categories of income, they impose statutory withholding taxes on dividends,

[12] It should also be noted that the amount of withholding tax levied *above* the permitted double tax treaty rate is not typically creditable under the laws of the residence state, as the double tax convention obliges the residence state to provide a credit only for the taxes levied by the other contracting state "in accordance with the convention." Articles 23A and 23B of the OECD Model Convention.
[13] According to the case law of the Court of Justice, a 25 percent holding requirement would certainly qualify as a piece of legislation aiming at benefiting situations of definite influence, falling within the scope of the freedom of establishment. See Case C-382/16, *Hornbach*.
[14] Wolfgang Schön, "International Tax Coordination for a Second-Best World (Part II)."
[15] Ibid.
[16] Unless the receiving company's State grants indirect credit or exemption for the dividend income.
[17] Wolfgang Schön, "International Tax Coordination for a Second-Best World (Part II)."
[18] Ibid.

interest, and royalties. Those statutory rules, however, provide only a partial picture of the Proposal's effect on Member States' tax revenues.

As seen in section 1.1. above, EU law and DTCs constrain the source Member States' ability to levy withholding taxes, *in toto* or in terms of rate. Furthermore, EU law or DTCs can require residence Member States to credit the withholding taxes levied at source. This means that capital-exporting countries generally provide credit for the taxes withheld at source. Capital-importing countries instead keep the revenues from the taxes withheld at source. The elimination of withholding taxes on outbound payments has positive revenue impacts for the former and negative revenue impacts for the latter.

Eurostat's balance of payments statistics show that net exporters of portfolio investments are Germany, Italy, Sweden, Denmark, Belgium, Greece, Portugal, Cyprus, Malta, Croatia, Bulgaria, Estonia, Lithuania, Slovakia, Slovenia, and Latvia; while net importers of portfolio investments are Luxembourg, France, the Netherlands, Ireland, Spain, Poland, Romania, Hungary, Austria, Finland, and Czechia.[19]

Bearing in mind the important caveat that these figures combine assets and liabilities held *within and outside of the EU*, this picture shows that the Proposal might have a negative revenue impact only on those capital-importing countries that currently levy withholding taxes on dividends, interest, and royalties of portfolio investors. To the contrary, it might have positive revenue impacts on portfolio capital-exporting countries, such as Italy or Germany, currently providing credit for those withholding taxes levied abroad.

1.5. Mitigating the Revenue Shortfall: A Revenue-Sharing Clause or an EU Own Resource

The asymmetrical revenue impact has been brought forward as a concern by multiple Member States. The claim is that by allowing all flows to go untaxed in the country of source, the directives (especially the IRD) would become instruments that re-allocate taxing powers on these income categories exclusively to the residence Member States.[20]

While (re)allocating taxing powers does not have any impact on economic growth per se, complying with an ineffective allocation does. It has been shown in the sections above that EU law and DTCs leave situations of definitive double taxation to persist within the Union, and that lengthy refunds for over-withheld taxes discourage cross-border investment. As a result, (re)allocating taxing rights in a simpler way by establishing that source countries need not burden outbound payments with taxes does advance the internal market.

However, making cross-border payments flow untaxed does not need to entail an asymmetrical revenue cost. The now-repealed Savings Directive, which transitionally required certain source Member States to tax savings income through a withholding tax, foresaw a revenue sharing mechanism according to which source Member States would retain 25 percent of the withholding tax revenues and residence Member States the remaining 75 percent. Inspired by this solution, it is proposed here that the Council insert a revenue-sharing clause in the directives under which capital-exporting countries that would

[19] Eurostat, *Balance of Payment Statistics 2026*, https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Balance_of_payments_statistics_-_quarterly_data#Geographical_breakdown_of_current_account_transactions.
[20] Council of the European Union, Interinstitutional files: 2026/0163 (CNS), WK 11001/2026 INIT, 27 July 2026.

gain from the Proposal transfer all or part of that gain to capital-importing countries that would lose revenue from its adoption.

In practical terms, the objective would be to preserve the Proposal's removal of withholding taxes while compensating for its uneven fiscal effects. Member States that gain because they no longer need to credit foreign withholding taxes would contribute toward offsetting the revenue lost by Member States that can no longer collect those taxes at source.

Because tracing individual dividend, interest, and royalty flows would be complex, the revenue-sharing clause could instead use a statistical formula. The formula would first approximate the annual returns on aggregate equity and debt assets held in other Member States. It would then apply separate rates to the (assumed) dividend, interest, and IP rights returns to calculate the amount that capital-exporting countries would transfer to capital-importing countries.[21]

For dividends, it is suggested that a rate of 2.34 percent be applied to the assumed return on equity. The rate is intended to approximate the average maximum withholding tax that a Member State could impose on an outbound dividend consistently with CJEU case-law.

As explained in section 1.1.1, when resident and non-resident corporate shareholders are in comparable situations, the source Member State may not tax an outbound dividend more heavily than an equivalent domestic dividend. The relevant benchmark is therefore the domestic tax burden borne by a resident company receiving a dividend, rather than the statutory withholding tax rate virtually applicable to the outbound payment.[22]

The calculation translates that benchmark into an EU average in two steps. First, it determines the average share of domestic dividends that remains taxable in the hands of resident corporate recipients after applying domestic exemptions or partial inclusions across all EU Member States.[23] Second, it multiplies that average taxable share by the average EU corporate income tax rate, including applicable surcharges and regional taxes.[24] Expressed schematically: average EU CIT rate × average taxable share of domestic dividends = 2.34 percent.

For interest and royalties instead, it is suggested to apply a rate of 6 percent on (assumed) interest and IP rights yields.[25] This common rate is based on average DTC-based withholding tax rates on interest and royalty income in DTCs among EU Member States.

The formula could be updated annually in two respects: each Member State's classification as a capital importer or exporter and the applicable rates, to reflect changes in domestic CIT rates and DTC withholding tax rates.

An alternative with a clearer EU-wide distributional rationale would be to treat these amounts as EU own resources. Rather than benefiting a single Member State, the revenue forgone

[21] In its impact assessment accompanying the Proposal, the European Commission assumes the 2.4 percent European Central Bank's 10-year government bond yield and 2.5 percent for equity, based on the EuroStoxx 600 average yield in 2024. For royalties, the European Commission looks directly at Eurostat's Balance of Payments' international royalty flows.
[22] This number takes the source state perspective only. It does not take into account whether the less favorable treatment could be mitigated by a double tax convention because the number of potential bilateral combinations would make it very difficult to come to a single number.
[23] Author's calculations based on data from a survey of the methods used by EU Member States to avoid double taxation of corporate shareholders on domestic dividend distributions, gathered mostly through PwC's tax summaries.
[24] Cristina Enache, "Corporate Income Tax Rates in Europe, 2026," Tax Foundation Europe, January 2026.
[25] Author's calculations of the EU withholding tax treaty average rates on interest and royalty income based on OECD Data Explorer, "Treaty based withholding tax rates - Corporate tax statistics 2026."

would finance common EU expenditures. Only capital-exporting countries would transfer amounts to the EU budget because, absent such a transfer, they would benefit from the Proposal by no longer having to credit foreign withholding taxes. The amounts transferred would roughly correspond to the foreign tax credits they currently grant, making the operation broadly revenue-neutral for those countries compared with the status quo.

The position of capital-importing countries is different. Compared with the status quo, they would lose the revenue they currently collect from outbound withholding taxes and would not receive a direct fiscal transfer in return. They would nevertheless benefit collectively from the fact that capital-exporting countries would continue to forgo an equivalent amount of revenue, now to finance common EU expenditures rather than foreign tax credits.[26] As a result, there is equity in the distributional key of the own resource.

2. The Anti-Tax Avoidance Directive as a Minimum Standard

Article 3 of the ATAD provides that the Directive is only a minimum standard of protection of Member States' tax bases. This means that, subject to compliance with the EU Treaties, Member States can go beyond the measures contained in the ATAD. The Proposal puts this in question in several of the proposed provisions.

2.1. CFC and Interest Limitation Rule: Minimum or Maximum Harmonization?

As noted already in our June 2026 blog post,[27] the controlled foreign company (CFC) provision and the interest limitation rule in the Proposal contain wording that might limit Member States' ability to go beyond the "minimum standard" set by the Directive. However, it does so in a manner that remains unclear.

Whereas the new exclusions from the CFC seem to be mandatory, it is not clear whether the same holds true for Model A or the one-third of passive income exclusion, as there is no explicit prohibition on the Member States adopting rules that differ from them, and yet the Proposal uses the wording "the Member States shall."

Member States and taxpayers therefore face three potentially conflicting signals: (i) Article 3 states the general rule that Member States may adopt measures that go beyond ATAD's minimum standard; (ii) the proposed CFC rule expressly prohibits divergence from only certain provisions; and (iii) other provisions outside that express prohibition use the mandatory formulation "Member States shall." It is therefore unclear whether those other provisions establish exhaustive requirements or remain subject to Article 3's minimum-standard approach.

This lack of clarity gravely undermines the harmonization effort that justifies the adoption of a directive under Article 115 TFEU, as Member States might interpret those provisions in a constellation of different ways. This has repercussions for the competitiveness of the EU's tax system at large, and legal certainty for businesses operating within it.

[26] Besides, the ceiling being equal, the new own resource would lower Member States' GNI-based own resource quota.
[27] Martha Caziero, "Is the European Commission's Tax Omnibus Proposal a Step in the Right Direction?" Tax Foundation Europe, June 2026.

Directives may combine different forms of harmonization,[28] and the Proposal appears to move ATAD in that direction. ATAD Article 3 should therefore be amended to state that the Directive establishes a minimum standard of protection "unless otherwise provided." Under this approach, the minimum-standard rule would continue to apply by default, while provisions using "Member States shall" or other explicit language of exhaustiveness would operate as maximum harmonization.

In parallel, the CFC provision should follow one of two approaches. The first would delete the new paragraph eight—the express prohibition—and use "shall" for mandatory provisions and "may" for optional provisions. The second would retain paragraph eight but extend its express prohibition to paragraphs two and three, making clear that all of those provisions are mandatory.

2.2. The R&D Full Expensing as Minimum Harmonization

In a similar fashion, the Proposal clarifies that the newly introduced R&D full expensing provision is a minimum harmonization provision, meaning that Member States can maintain or introduce alternative domestic measures if they consider those domestic measures to provide a more favorable treatment than the one granted by the Proposal. Member States are rightfully concerned about how to assess that equivalence.[29]

The R&D full expensing provision requires Member States to allow the taxpayer to deduct qualifying R&D capital expenditure from their taxable base in the year of acquisition, or within four years.

Subject to compatibility with the state aid prohibition, Member States could grant full expensing to a broader set of asset classes, or extend the period in which the application could be made. However, as there is a variety of R&D incentives in place, Member States are doubtful as to whether their own existing incentive is more favorable than the Proposal's.

Depreciation schedules require businesses to deduct investment costs from their taxable income over multiple years, typically reflecting an asset's expected lifespan. However, since deductions arrive only gradually, inflation and the time value of money erode their value in real terms, raising the cost of capital. The longer the depreciation schedule, the smaller the share of investment costs businesses can recover. Full expensing fixes this by allowing deduction of the entire amount of capital expenditure in the year of acquisition, making the amount of nominal deduction coincide with the real value of the expense.[30]

As a result, one criterion to determine equivalence between a domestic R&D incentive and the Proposal's full expensing might be the net present value of deductions allowed. In other words, if the domestic rule allows the taxpayer to recover at least the real value of its capital investment, the rule is equivalent. Neutral cost recovery rules would be an example, as they adjust depreciation allowances for inflation and a notional return on capital.[31] In certain cases, a super deduction might also give the same economic result.

[28] The Audiovisual Media Services Directive—Directive 2010/13/EU—is an example of a directive that contains clauses of partial, optional, and minimum harmonization, making it difficult to attribute to it an overall harmonization model. See Amedeo Arena, "The Doctrine of Union Preemption in the EU Single Market: Between Sein and Sollen," *Jean Monnet Working Paper* 03/10, NYU School of Law.
[29] Council of the European Union, Interinstitutional files: 2026/0163 (CNS), WK 11001/2026 INIT, 27 July 2026.
[30] Lisa Hogreve and Daniel Bunn, "Capital Cost Recovery across the OECD, 2022," Tax Foundation Europe, April 2022.
[31] Martha Caziero, Alexander Mengden, Sean Bray, Julius Graack, "Does the EU Tax Omnibus' R&D Expensing Proposal Make the EU More Competitive?" Tax Foundation Europe, July 2026.

However, the variety of options potentially emerging from the Proposal only establishing a minimum floor puts into question whether the provision would realize its harmonization goal. This might be problematic from the perspective of the legal basis used for the directive's adoption—Article 115 TFEU—as the Court of Justice requires that a directive genuinely aims at removing obstacles to the internal market. If the obstacle that the Proposal is aiming at removing is different R&D incentive rules across Member States, having a variety of (economically equivalent) incentives might not deliver on the objective. If the obstacle is facing different tax liabilities for businesses engaged in R&D activities across EU Member States, the provision does not fix that, as it does not establish a common corporate tax base and rate. Hence, it is suggested to clarify the scope of the R&D full expensing provision and the alternative regimes that would be equivalent to it.

3. Conclusions

Tax Foundation Europe considers the Proposal broadly favorable to the functioning of the internal market and focuses on two legal issues with implications for EU economic growth. First, eliminating the holding thresholds for withholding tax exemptions could strengthen the internal market, particularly if accompanied by simpler requirements for obtaining relief. Although especially the IRD amendments would shift taxing rights toward residence Member States, their uneven fiscal effects could be addressed through a statistical revenue sharing mechanism or by treating the corresponding amounts as an EU own resource. Second, the ATAD amendments blur the directive's character as a minimum standard. Article 3 and the CFC provision should therefore distinguish expressly between mandatory and optional rules. The Proposal should also define which domestic R&D regimes are equivalent to full expensing by reference to a clear criterion, such as the real value of the deductions they provide.