# The Energy Crisis: A legality analysis of the new Spanish windfall profits tax on energy corporations with EU law and Double Tax Conventions

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## Preface

This thesis symbolizes the end of my student journey in my master's degree study International Business Taxation at Tilburg University. I would like to dedicate my gratitude and acknowledgement to the people that have supported me in this journey and gave me positive words every time I needed it.

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## Abstract

The invasion of Ukraine by Russia plunged the European energy market into a full fledge crisis resulting in an economic recession of the Eurozone, while energy corporations were reporting record profits amounting to billions. As an answer to windfalls in the energy market, the EU established a windfall profits tax on energy corporations via an emergency regulation to fund crisis relief policies. The regulation establishes a binding rule of minimis, and it is the first ever EU-wide windfall profits tax. For that reason, the thesis aims to discover what are the potential legality issues surrounding the new levy. More specifically, the thesis will focus on the case study of Spain, as their implementation has derogated considerably from the regulation. Therefore, the main research question of the thesis is, what are the potential issues of legality of the new Spanish solidarity contribution on energy corporations? The thesis, following a traditional legal methodology, will explore the issues of legality of the Spanish levy at a European and International level via three sub-questions. The normative benchmark will develop basic taxation concepts like discrimination or the concept of income tax. The conclusion of the analysis demonstrates that the Spanish levy is compatible with the EU regulation, it does not lead to any type of discrimination and is thus compatible with the fundamental freedoms, and finally, it is covered by the OECD Model Convention. Therefore, the thesis's main claim is that the Spanish solidarity contribution does not lead to any issues of legality either at a European or International level. The results contribute to the academic debate on whether windfall profit taxes are an appropriate legal tool to tackle crises caused by extraordinary events within the EU.


*Keywords: Windfall profits tax, Spanish solidarity contribution, legality, rule of minimis, discrimination, tax treaty applicability.*

## Abbreviations

| | |
|---|---|
| CIT | Corporate Income Tax |
| DST | Digital Services Tax |
| EC | European Commission |
| ECB | European Central Bank |
| ECJ | European Court of Justice |
| ETS | Emissions Trading System |
| EU | European Union |
| FISC | Financial Crimes, Tax Evasion and Tax Avoidance |
| GAAP | Local Generally Accepted Accounting Principles |
| IFRS | International Financial Reporting Standards |
| IT | Italy |
| LGP | Liquefied Petroleum Gases |
| MAP | Mutual Agreement Procedure |
| MS | Member State(s) |
| OECD | Organization of Economic Cooperation and Development |
| OPEC | Organization of the Petroleum Exporting Countries |
| PE | Permanent Establishment |
| PT | Portugal |
| TEU | Treaty of the European Union |
| TFEU | Treaty of the Functioning of the European Union |
| UAE | United Arab Emirates |
| UK | United Kingdom |
| US | United States |
| VCLT | Vienna Convention on the Law of Treaties |

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# Chapter 1: Introduction

## 1.1 The Energy Crisis

The already weakened European energy market by the Covid-19 crisis, suffered a new blow when Russia started a military invasion of Ukraine in February 2022. Russia being one of Europe's main gas suppliers with an annual gas contribution of 40%, reduced the supply by 80%, highlighting Europe's dependency on foreign fossil fuels[1]. Energy prices have since skyrocketed by fifteen-fold compared to prices at the beginning of 2021. The result has been increased energy poverty with households that cannot afford to heat their homes, the rising cost of production and consequent increased food prices, and a soaring inflation rate of 10% in the Euro area[2]. All factors together combined with extreme volatility in the markets have strained the euro economy, with the ECB alerting of a potential recession. In contrast, oil gas and refinery corporations have reported record profits during 2022. For instance, energy company Shell disclosed in their financial statements in the third quarter of 2022 a net profit of 9.45 billion dollars, a double increase compared to the same period the previous year[3]. Profits in the industry have been unprecedented to the point that five major oil companies together have made nearly a total net profit in 2022 of 200 billion dollars[4].

Economists have argued that these profits are a direct consequence of price turmoil in the energy market, characterising them as windfall profits. Legally a windfall is defined as "a value which is received by a person unexpectedly as a result of good fortune rather than as a result of effort, intelligence, or the venturing of capital"[5]. From this definition, it is assumed that a windfall is profits that do not result from investment or planned risk activities by economic agents, but rather they are the result of unforeseen events like wars[6]. States can tax these extraordinary profits through a windfall profits tax, either in the form of an excise or a profits tax, and redistribute the revenue with the public interest in mind. The tax is a neutral instrument as it does not distort taxpayers' behaviour, nor does it create a deadweight loss[7]. This is because the taxable base is defined as the excess profits over an assumed normal profit, it does not affect production levels and is borne by shareholders through lower dividend distribution[8]. Windfall profits taxes are, therefore, an efficient instrument to raise public

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[1]Conall Heussaff et al. "An assessment of Europe's options for addressing the crisis in energy markets." *Bruegel Policy Contribution*, no. 17 (2022).
[2] Christian Ehler, et al., "European Parliament resolution on the EU's response to the increase in energy prices in Europe", *European Parliament*, (October 2022), pp. 4-6.
[3] Stanley Reed. "Shell and Total, Oil Giants, Report Huge Profits on High Energy Prices". *The New York Times*, (October 2022).
[4] Isabel van Halm, "Big Oil profits soared to nearly $200bn in 2022", *Energy Monitor*, Published February 8, 2023; https://www.energymonitor.ai/finance/big-oil-profits-soared-to-nearly-200bn-in-2022/
[5] Eric Kades. "Windfalls." *The Yale Law Journal 108*, no. 7 (May 1999), p. 1.
[6] Lucy Chennells, "The Windfall Tax", *Fiscal Studies* 18, no. 3 (1997), pp. 287-288.
[7] Ibid, p. 289.
[8] Carl C. Plehn, "War Profits and Excess Profits Taxes", *The American Economic Review* 10, (June 1920), p. 284.

revenue and spread risk across the economy that can be used successfully to mitigate the impact of economic crisis.

The extent of windfall profits in the energy sector due to the war in Ukraine has outraged the public opinion and policy makers alike, which have repeatedly asked for an effective EU wide windfall profits tax, arguing that "exceptional times require exceptional measures"[9]. The European Commission, thus, proposed in September a package of measures including a solidarity levy, aimed at energy companies. The new regulation, which was approved by the council in October 2022, is binding and directly applicable to all MS until December 2023[10]. The main aim of the windfall profits tax is to redistribute the surplus profits of energy corporations with final energy consumers, to curb the harmful effects of the energy crisis and finance decarbonisation measures[11]. The windfall profits tax applies with a temporary character in addition to other levies and needed to be adopted by MS no later than December 2022[12].

### 1.2 Motivation for the Research

Since windfall profits taxes were conceived in the twentieth century as war levies in both world wars to target excess profits in the munitions industry, they have only been used a handful of times during peacetime. Examples are the US crude and oil windfall profits tax in 1980 after the consolidation of the OPEC cartel or the UK windfall profits tax in 1997 on privatized utility companies. The scarce examples of windfall profits tax have resulted in limited literature about their effects and legal issues, meaning they remain widely unexplored.

On the one hand, economic scholars have focused on testing whether indeed windfall profits taxes are efficient. Plehn's early analysis found that the benchmarking used to calculate the tax base using a definition of unearned profits, can become obsolete rapidly as the market conditions change[13]. As a result, the tax affected taxpayer's behaviour, who would use depreciation and profit allowances to reduce the taxable income, ultimately allowing tax planning and reducing overall tax revenues[14]. These conclusions were confirmed by economic models showing that in the long run the US 1980 crude oil tax was borne by domestic oil producers, unintendedly reducing oil supply, and causing a high administrative burden[15]. Even though windfall profits taxes can raise high revenue and are a

[9] European Parliament resolution on the EU's response to the increase in energy prices in Europe (2022/2830(RSP)), *European Parliament*, (October 2022), p. 6.
[10] Council Regulation (EU) 2022/1854, of 6 October 2022, on an emergency intervention to address high energy prices. (2022), *Official Journal* L 261, Article 14, p. 18.
[11] Ibid, Article 17, p. 19.
[12] Ibid, Article 19(4a), p. 19.
[13] Carl C. Plehn, "War Profits and Excess Profits Taxes", *The American Economic Review* 10, (June 1920), p. 287
[14] Ibid p. 298
[15] Dale E. Lehman & Stepehen L. McDonald, "Reader Response: A re-examination of the crude oil windfall profit tax", *Natural Resources Journal* 21, no. 4 (October 1981): pp. 683-692.

redistributive instrument, their shortcomings in the long run imply they are not a wise economic policy solution to general energy market price increases[16].

On the other hand, legal scholars have explored the justifications behind taxing windfall profits. Windfall profits could be classified as private property, but Kades argues that even if windfalls are private property in the hands of individuals, courts can allow taxation in cases where windfalls can serve the public good and are easy and cheap to detect[17]. In the EU, legal scholars have focused on studying if the benefits obtained by certain sectors under the EU ETS were in conformity with State aid rules. In the case *Iberdrola and Others v. Administración del Estado,* the court ruled that EU law did not give a right to windfall profits derived by the implementation of the ETS regulation, and thus MS were entitled to limit windfalls through national measures[18]. This judgement halted the academic debate on whether MS are entitled to tax windfall profits caused by EU law. The legal academic debate, however, has not investigated whether windfalls caused by economic, natural, or political events can be taxed legally by MS through windfall profits taxes. Overall, questions remain on the appropriateness of windfall profits taxes that the existing academic debate has not yet answered.

A literature gap exists on issues of legality, which are of extreme importance in light of the first ever EU wide windfall profit tax. The implementation landscape of the new regulation is fragmented across MS, with some choosing to deviate in the design of the tax base and applicable rate[19]. In other words, the windfall profits tax is not uniform across the EU, which could lead to distortions in the internal market and even infringement of the fundamental freedoms established in the TFEU. The new tax, furthermore, is presumably not included in double tax treaties among countries as it is an unconventional tax, posing a threat of double taxation. The case brought forward by the Internal Revenue Code against the UK's 1997 windfall profits tax showcases that windfall profits taxes can be challenged as not credible taxes, and thus are not eligible to receive foreign tax credit[20].

The thesis will, therefore, explore what are the different legality issues surrounding the new windfall profits tax on energy corporations, namely if there is a violation of EU law and incompatibility with double tax treaties. Since the thesis argues that the new regulation is a rule of minimis allowing MS to deviate considerably in their own design of the levy and exploring the

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[16] Salvatore Lazzari, "CSR Report for Congress: The windfall profit tax on crude oil: Overview of the issues", *The Congressional Research Service*, (September 1990), p. 1.
[17] Eric Kades. "Windfalls." *The Yale Law Journal 108*, no. 7 (May 1999), p. 24
[18] Daniel Pérez Rodríguez, "Absorbing EU ETS Windfall Profits and the Principle of Free Allowances: Ibredrola and Others", *Common Market Law Review* 51, (2014), p. 694.
[19] Gabriella Erdös & Gergely Czoboly, "New legislative Tool for Introducing EU-wide Windfall Taxes", *European Taxation* 63, no. 1 (December 2022), p. 3.
[20] Kirsten S. Linder, "Hybrid taxation: the dual function and credibility of the U.K. Windfall Tax", *American Bar Association* 62, no. 2 (December 2012), p. 2.

legality of the EU tax would be extremely broad in scope, the thesis will explore in depth the case study of Spain. Spain was chosen as they were one of the first MS to adopt a windfall profits tax before the Council approved the EU-wide regulation, resulting in a national levy that differs significantly from the EU. The aim of the thesis, therefore, is to identify any compatibility issue with the law that could threaten the existence of the Spanish windfall profits tax, named "solidarity contribution". Understanding if the solidarity contribution is legal, is fundamental to better the use of unconventional taxes within the EU and prevent them from being challenged in the courts. Windfall profit taxes, if designed properly, might become part of the toolkit available to policymakers to tackle windfall profits and redistribute funds to those who most need it during crisis. Finally, the thesis will initiate the discussion on the use of windfall profits taxes within the EU and their optimal design. Ultimately, the thesis will contribute to the current academic debate outlined above on whether windfall profits taxes are an appropriate mechanism to tackle unexpected situations in the short run.

### 1.3 Research Question

Given the topic of research identified, the thesis revolves around the following main research question:

*What are the potential issues of legality of the new Spanish solidarity contribution on energy corporations?*

In order to answer the research question, three sub-questions will be addressed:

1. To what extent is the implementation of the Spanish solidarity contribution compatible with the EU Emergency Council Regulation 2022/1854 on energy prices?
2. To what extent is the Spanish solidarity contribution compatible with the fundamental freedoms contained in the TFEU?
3. To what extent is the Spanish solidarity contribution compatible with the OECD Model Tax Convention on Income and on Capital?

### 1.4 Methodology

The methodology of the thesis adheres to traditional legal methods, which will allow to gain an understanding of what is the relation of the new windfall profits tax with other primary sources of law, being a legal compatibility analysis the driver of the research. For that reason, the thesis will be based on case law and legal literature from law journals and books. The delimitation of the thesis is based on the three sub-questions identified, which will lay the research steps based on two levels of fiscal law: European and International.

I. At a European level, the research will concentrate firstly on EU secondary law, in this case the Council Regulation that establishes the new windfall profits tax, and secondly EU primary law, the fundamental freedoms. As such, the main relevant source that will be analysed is the Council Regulation 2022/1854, the TFEU and case law on discrimination in direct taxation of the CJEU. Therefore, other founding treaties, the Charter of Fundamental Rights of the European Union, fiscal directives or other case law with respect to taxation, are out of the scope of the thesis.

II. From an international perspective the thesis will mainly cover articles 2 and 23 of the OECD Model Tax Convention. Given the explanatory nature of the potential situations of double taxation arising from the Spanish solidarity contribution, existing bilateral tax treaties agreed by Spain, MS or third countries, are not relevant and will not be taken into consideration.

Nonetheless, considering time and resource constraints, the thesis can only provide a preliminary assessment of what are the legal problems the new tax might encounter. The selection of sources as well as the case study of Spain, are inevitably influenced by the authors' biases, and thus future research should be conducted to complement the thesis.

### 1.5 Outline

The structure of the thesis is divided into 4 chapters. After the introduction in Chapter 1, Chapter 2 contains the compatibility analysis of the Spanish solidarity contribution with EU law, both secondary and primary law. The chapter will first compare the Spanish levy with the EU levy, arguing that given that the EU regulation establishes a rule of minimis, the Spanish levy is compatible with the EU windfall profits tax. The chapter will also develop the concept of discrimination in direct taxation, and it will show by applying the rule of reason and the concept of reverse discrimination that the Spanish levy does not create any instance of discrimination, and thus it is compatible with the EU fundamental freedoms. Next, Chapter 3 develops the compatibility analysis of the Spanish solidarity contribution with the OECD Model Tax Convention. It will argue that the levy is covered by the model and entitled to receive double taxation relief under tax treaties, and hence, the levy is compatible with the OECD Convention. The chapter will, furthermore, show that all instances of double taxation caused by the Spanish solidarity contribution, even those outside of the scope of the model, are resolved. Finally, Chapter 8 provides a conclusion to the main research question, which is that based on a substance over form analysis the Spanish solidarity contribution on energy corporation does not pose any issues of legality either on a European or International level. The chapter will also present research limitations and future research recommendations.

## Chapter 2: Compatibility of the Spanish Solidarity Contribution with EU Law

On 24 November 2022, after intense debates and several amendments, the Spanish congress finally approved a temporary windfall profits tax on energy corporations named "solidarity contribution". The intention to introduce the tax had been announced in late June 2022, as part of a package of measures aimed to mitigate the economic and social impact the war in Ukraine was having in Spain. The State justified the levy on the need to create a tool to intervene in the economy to share the burden of the negative impacts of the energy crisis, particularly the effects of inflation, by redistributing the profits of those entities that were benefiting the most from high energy prices. The first draft of the proposal was submitted to the parliament by the end of July, meaning the tax was designed before the commission drafted their proposal on a EU-wide windfall profits tax in September. The result has been that the Spanish solidarity contribution differs significantly in design compared to the EU levy in terms of scope, tax base and applicable rate.

### 2.1 Comparison of the Spanish and EU Windfall Profits Taxes

The scope of the Spanish solidarity contribution is not only the oil and gas industry but the energy sector as a whole, including electricity generation and renewable energies. Entities considered principal operators in the energy sector are liable to pay the solidarity contribution[21]. As defined by the National Commission of Markets and Competition, principal operators are operators in a specific sector of the market that owns one of the five major quotas of the corresponding industry they operate in[22]. In other words, any legal entity that holds more than 10% of the market share in the energy sector would be considered a principal operator. Nonetheless, the tax excludes principal operators that had a "importe neto de la cifra de negocios" in 2019 of less than 1.000 million euros or those entities that did not derive more than 50% of their "importe neto de la cifra de negocios" from activities in the energy sector in 2017, 2018 and 2019 respectively[23]. Finally, legal entities carrying out activities in Spain with at least 75% of their business volume derived from activities in the crude, petroleum, natural gas, coal and refinery sectors, are also liable to pay the solidarity contribution[24].

In comparison, the scope of the EU windfall profits tax is extremely narrower as it only targets the fossil fuels sector. The regulation stipulates that Union companies and PE with at least

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[21] "Ley 38/2022, de 27 de diciembre, para el establecimiento de gravámenes temporales energético y de entidades de crédito y establecimiento financieros de crédito y por la que se crea el impuesto temporal de solidaridad a las grandes fortunas, y se modifican determinadas normas tributarias", *BOE* no. 311, BOE-A-2022-22684, Article 1(1), p. 185782.
[22] Real Decreto Ley 6/2000, de 23 de Junio, de Medidas Urgentes de Intensificación de la Competencia en Mercados de Bienes y Servicios, *BOE* no. 151, BOE-A-2000-11836, Article 34(2), p. 22453
[23] "Ley 38/2022, de 27 de diciembre, para el establecimiento de gravámenes temporales energético y de entidades de crédito y establecimiento financieros de crédito y por la que se crea el impuesto temporal de solidaridad a las grandes fortunas, y se modifican determinadas normas tributarias", *BOE* no. 311, BOE-A-2022-22684, Article 1(2), p. 185783.
[24] Ibid, Article 1(2), p. 185783.

75% of their turnover derived from activities in the crude, petroleum, natural gas, coal and refinery sectors, are liable to pay the windfall profits tax[25]. Union companies are defined as any legal entity established in a MS considered to be tax resident by domestic tax laws, and which under double tax treaties is not considered a tax resident outside the Union[26]. Additionally, a PE is defined as a fixed place of business located in a MS where the profits derived from the business are subject to tax in that MS[27]. The Spanish law, in contrast, refrains from explicitly mentioning PE.

The Spanish contribution tax base is the "importe neto de la cifra de negocios" derived from activities in the energy sector carried out in Spain during the year before the payment obligation of the tax arises[28]. Under the Spanish local GAAP, "importe neto de la crifra de negocios" is calculated by summing the earnings from the sale of goods and/or services without including any allowances minus any commercial discount or devolutions that occurred during that period[29]. For the purpose of the levy, however, the special fuel tax and sales derived from the regulated energy market controlled by the government, including LGP gas, are excluded from the calculation[30]. In the case the legal entity is part of a Spanish fiscal group, only the activities of the group as such will be relevant, yet the law does exclude any earnings obtained in other countries and will "exclusively tax the Spanish entities of the group"[31]. The equivalent of the "importe neto de la crifra de negocios" under IFRS 15 would be net sales, which is the gross sales of the enterprise minus returns, allowances and discounts, and is ultimately displayed in the revenue account of the income statement[32]. Therefore, the taxable base of the Spanish levy as defined by international standards is net sales, meaning the solidarity contribution taxes revenues with a tax rate of 1.2% over the taxable base[33].

In comparison, the tax base of the EU windfall profits tax are the net profits determined under national rules in the fiscal years 2022/23 which are above a 20% increase of the average of the taxable

[25] Council Regulation (EU) 2022/1854, of 6 October 2022, on an emergency intervention to address high energy prices. (2022), *Official Journal* L 261, Article 14(1), p. 18
[26] Ibid, Article 2 (15), p. 12.
[27] Ibid, Article 2(16), p. 12.
[28] "Ley 38/2022, de 27 de diciembre, para el establecimiento de gravámenes temporales energético y de entidades de crédito y establecimiento financieros de crédito y por la que se crea el impuesto temporal de solidaridad a las grandes fortunas, y se modifican determinadas normas tributarias", *BOE* no. 311, BOE-A-2022-22684, Article 1(5), p. 185783.
[29] "Real Decreto 1514/2007, de 16 de noviembre, por el que se aprueba el Plan General de Contabilidad", *BOE* no. 278, BOE-A-2007-19884.
[30] "Ley 38/2022, de 27 de diciembre, para el establecimiento de gravámenes temporales energético y de entidades de crédito y establecimiento financieros de crédito y por la que se crea el impuesto temporal de solidaridad a las grandes fortunas, y se modifican determinadas normas tributarias", *BOE* no. 311, BOE-A-2022-22684, Article 1(5), p. 185783.
[31] Ibid, Preamble I, p. 185779.
[32] Deloitte, "Revenue from Contracts with Customers: A guide to IFRS 15", *Deloitte Network* (2018).
[33] Ibid, Preamble I, p. 185779.

profits of the last four fiscal years[34]. In other words, the EU tax is levied on income, and those entities within the scope are subject to a 33% tax rate[35].

**Table 1**

| *Comparison of levies* | | |
|---|---|---|
| | *Spanish Solidarity Contribution* | *EU Windfall Profits Tax* |
| Scope | a. Principal Operators of the energy sector, with more than 1.000 million net sales in 2019 and more than 50% of earnings derived from energy in 2017/18/19.<br>b. Entities in Spain with at least 75% of their business volume derived in Spain from activities in the crude, petroleum, natural gas, coal and refinery sectors. | a. Union companies and PE with at least 75% of their turnover derived from activities in the crude, petroleum, natural gas, coal and refinery sectors. |
| Taxable Base | Net sales of fiscal year | Profits of fiscal year above a 20% increase over the average profits of 2018/19/20/21 |
| Tax Rate | 1.2% | 33% |
| Type of Tax | Revenue Tax | Income Tax |

As seen in Table 1, the differences between the Spanish contribution and the EU tax are considerable, but the most impactful difference is that the former taxes revenue while the latter taxes income. Arguably net sales taxes tend to be more burdensome as they do not entirely reflect the ability to pay of taxpayers. For instance, a corporation might have a profitable revenue, yet if it has big depreciation allowances, costs of production or investment expenses, the economic reality would be that they are operating at a loss. Thus, the firm's financial capacity would be illusory, and the tax would be paid to the detriment of the firm's capital. In other words, the Spanish solidarity levy is not applying a progressive tax based on wealth. Furthermore, the Spanish design contradicts the fundamental principle of windfall profit taxes, which is taxing unforeseen profits deriving from an extraordinary event. Contrary to the EU tax which identifies the level of windfall profits over an

[34] Council Regulation (EU) 2022/1854, of 6 October 2022, on an emergency intervention to address high energy prices. (2022), *Official Journal* L 261, Article 15, p. 18.
[35] Ibid, Article 16, p. 18.

assumed normal profit in the last years, the solidarity contribution taxes all revenue coming from the economic activity of energy corporations. While it is true the tax targets big energy corporations that have profited the most from the war in Ukraine, under the current design, profits deriving from investment or planned activities would also be taxed. Moreover, the tax will also not be considered a deductible expense for CIT[36]. Therefore, the Spanish tax is not an efficient neutral economic policy tool, meaning despite the lower tax rate, a priori it appears to be more burdensome than the EU tax.

### 2.2 The EU Windfall Profits Tax: A regulation of minimis

Traditionally taxation has been an area in which harmonization at a supranational level is difficult to achieve since taxes are fundamental to the establishment of the welfare state through their contribution to national budgets. For that reason, states are reluctant to give away their fiscal sovereignty as they want to protect their power to enact and modify national tax systems to their convenience. This struggle is reflected in the functioning treaties of the EU, in which MS have retained competence over direct taxation, allowing them to legislate freely with the sole constriction of the EU fundamental freedoms and some EU directives[37]. As a result, harmonization of direct taxation at EU level has only taken place via directives approved based on Article 115 TFEU. This article states that the council acting unanimously and after consultation with different EU institutions, can enact directives or regulations necessary to ensure the functioning of the internal market[38]. Proposals regarding taxation, thus, can only be achieved through unanimity, a process that can take long as all MS interests need to be considered.

The new EU wide windfall profits tax proposed by the EC was, however, approved by the Council with majority voting under Article 122 TFEU. This article allows the Council to implement measures appropriate to the economic situation if there are supply difficulties, notably in the area of energy[39]. Through this unprecedented move, the Council established the first ever fiscal measure to be approved with majority voting. This approach was preferred mainly to prevent unilateral action of MS, as some countries like Spain had already announced similar taxes, by guaranteeing bureaucratic speed[40]. The measure has, however, unknown fiscal consequences as for the first time a tax has been designed in the form of a regulation, which is binding and directly applicable to all MS until December 2023. The main difference as stated by Article 288 TFEU between a regulation and a directive is that the latter "leaves national authorities the choice of form and methods" to achieve the

[36] Ibid, Article 8, p. 13.
[37] 3. Peter Wattel, "General EU Law Concepts and Tax Law", in A *Terra/Wattel European Tax Law*, ed. Peter Wattel, Otto Mares & Hein Vermeulen (Deventer: Wolters Kluwer, 2018), p. 27
[38] Consolidated version of the Treaty of the Functioning of the European Union (2012), *Official Journal* C326/47, Article 115, p. 95.
[39]Ibid, Article 122, p. 98.
[40] Council Regulation (EU) 2022/1854, of 6 October 2022, on an emergency intervention to address high energy prices. (2022), *Official Journal* L 261, Preamble, pp. 1-3.

binding result stipulated by the legislation[41]. MS, thus, need to conform to the regulation without the freedom of deciding how to transpose it into national law, nor establish how they want to achieve the goals of the regulation.

In theory, the windfall profits tax design would have been completely harmonized in the EU. This means that the Spanish solidarity contribution needed to be the same in design as the EU windfall profits tax and as seen above the levies are significantly different, meaning the Spanish levy would not be compatible with the regulation. Nevertheless, Article 14 of the new emergency regulation states that MS can enact equivalent national measures to the windfall profits tax proposed, as long as they share the same objectives, generate comparable or higher proceeds, and they are similar to the contribution[42]. In other words, MS are free to decide on the design of the windfall profits tax provided the levy taxes somehow the surplus profits of the energy companies with similar revenue streams. The door is, thus, open for MS to lawfully derogate significantly from the regulation by simply complying with certain standards of comparability.

Other fiscal directives have similar provisions, like ATAD, that establish minimum standards instead of absolute rules MS need to comply with. Article 3 ATAD states that "the directive shall not preclude the application of domestic or agreement-based provisions aimed at safeguarding a higher level of protection for domestic corporate tax bases"[43]. The nature behind enacting the directive was to create a minimum level of protection across the EU while still complying with the principle of proportionality and subsidiarity[44]. These two principles allow the EU to intervene in non-exclusive competent areas when goals can be better achieved at EU level but without going further than necessary[45]. As a result, under ATAD MS are not prohibited to enact measures that will be more burdensome than what is otherwise stated in the Directive, only the minimum standard is binding. When comparing Article 3 of ATAD and Article 14 of the new regulation, it can be argued that the regulation establishes a minimis rule and does not prohibit MS to go beyond what is necessary. Article 14 minimum standard is the creation of a windfall profits tax on energy that will generate at least the same amount of proceeds to be used in accordance with the objectives prescribed.

The establishment of a minimis rule in the form of a regulation is mostly, explained by the constraints placed on the Commission to find a political consensus and the need to accommodate existing legitimate national windfall profits taxes. Furthermore, despite adopting the regulation on majority voting, the Commission needed to comply with the principle of proportionality and

[41] Consolidated version of the Treaty of the Functioning of the European Union (2012), *Official Journal* C326/47, Article 288, pp. 171-172.
[42] Ibid, Article 14, p. 18.
[43] Council Directive (EU) 2016/1164, of July 12 2016, laying down rules against tax avoidance practices that directly affect the functioning of the internal market, *Official Journal* L 193/1, Paragraph 2 & 3, p. 1.
[44] Caroline Docclo, "The European Union's ambition to Harmonize Rules to Counter Abuse of Member States' Disparate Tax Legislations", *Bulletin for International Taxation* 71, no. 7 (June 2017), p. 3.
[45] Consolidated version of the Treaty on European Union (2002), *Official Journal* C325/5, Art. 5, p. 18.

subsidiarity, and by only establishing a minimum standard they still abided by it. Common rules at an EU level need to fit 28 different tax systems. For that reason, Article 122 was seen as an innovative tool that would not create a true fiscal regulation, ultimately respecting MS fiscal competence, as the latter are still the recipients of the revenue raised and have some leniency in how to use it.

Given that this thesis argues that the regulation is a rule of minimis, even if the Spanish solidarity contribution due to its design is more burdensome than the EU windfall profits tax, it still needs to be compatible with the regulation. This issue has sparked a heated debate in Spain, especially energy corporations within the scope of the Spanish levy have expressed that the levy is unjustified compared to the EU levy as it is the only tax in the Union that taxes net sales. They argue, thus, that the levy is fundamentally not compatible with the EU regulation. This thesis, however, takes a different approach and argues that the Spanish solidarity contribution is equivalent to the EU windfall profits tax.

Firstly, paragraph eleven of the Spanish law explicitly mentions for what purposes the revenue must and will be used. These include among others helping families and enterprises struggling with the energy crisis, funding energy autonomy as stipulated by the EU REPowerEU plan or funding the use of renewable energy[46]. Most of the objectives listed have been transposed from the objectives found in Article 17 of the EU regulation. Secondly, the Spanish government has predicted an annual tax revenue of 2.000 million euros from the contribution[47]. A recent study requested by the FISC committee predicts that if Spain would have followed the design of the EU tax, given the companies within the scope and their profits, the total tax revenue prediction is approximately 1.100 million euros[48]. Therefore, the Spanish tax would generate higher proceeds, going beyond the necessary total tax collection and thus adhering to the minimis rule stipulated by the regulation. Finally, the Spanish contribution has also included within its scope the inclusion of entities with more than 75% activities in the fossil fuel sector, mirroring the scope of the EU regulation. Therefore, the Spanish solidarity contribution is similar tax to the EU windfall profits tax, it shares the same objectives and raises higher proceeds.

To conclude, after examining the different provisions of the Spanish solidarity contribution, the levy is equivalent to the EU windfall profits tax as stipulated by Article 14 and thus not contrary to EU secondary law. Therefore, the answer to sub-question one is that the Spanish levy is fully compatible with the EU emergency regulation on energy prices. The analysis shows there is no

[46] "Ley 38/2022, de 27 de diciembre, para el establecimiento de gravámenes temporales energético y de entidades de crédito y establecimiento financieros de crédito y por la que se crea el impuesto temporal de solidaridad a las grandes fortunas, y se modifican determinadas normas tributarias", *BOE* no. 311, BOE-A-2022-22684, Article 1(11), pp. 185784-185785.
[47] Ibid, Preamble I, p. 185778.
[48] Katarina Nicolay et. al, "The effectiveness and distributional consequences of excess profit taxes or windfall taxes in light of the Commission's recommendation to Member States", *European Parliament* (March 2023), p. 40

effective exhaustive harmonization of windfall profits taxes within the EU, leaving open the possibility that Spain's implementation of the regulation does not comply with primary EU law. A lack of complete harmonization can lead to potential internal market distortions that could transform into instances of discrimination contrary to the fundamental freedoms. For that reason, the thesis will analyse whether the Spanish solidarity contribution leads to the discrimination of non-residents in the next subsections, aiming to discover if the contribution is compatible with EU primary law.

### 2.3 The Four Fundamental Freedoms of the EU

Since the creation of the EU in 1993, establishing an internal market has been a key instrument to foster the Union goals. As stated in Article 26 TFEU, "the internal market shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provision of the treaties"[49]. By eliminating any legal or bureaucratic obstacles, national markets can merge into one single market creating positive competition and free trade. The internal market is safeguarded by the four fundamental freedoms, namely free movement of goods, services, persons (workers and establishment), and capital. The freedoms encompass two basic rights, market access and market equality, the former being the right of cross border circulation, and the latter the prohibition of discrimination[50]. In general, the freedoms set the boundaries of exercising national tax jurisdiction and demand MS to stay neutral to cross border activities.

#### 2.3.1 The Concept of Tax in EU Law

Under the internal market framework, every form of national taxation would be considered an obstacle liable to hinder the economic activity of the internal market, and thus MS taxation would be entirely prohibited[51]. EU law does not explicitly define the concept of "tax" in the fundamental treaties. Nevertheless, the decision of the CJEU in the *IRCCS* case gave the concept of tax an ample interpretation. The court specified that for a levy to be considered a tax there must be, first an obligation to pay which in case of not being satisfied the debtor must be held accountable by the authorities, and secondly, the amount paid shall be used for the general interest as stipulated by the public authorities[52]. In principle, thus, the name of the levy or the flow of the money does not pay a role in determining the existence of a tax[53]. Accordingly, taxes from a European point would include

[49] Consolidated version of the Treaty of the Functioning of the European Union (2012), *Official Journal* C326/47, p. 59.
[50] 3. Peter Wattel, "General EU Law Concepts and Tax Law", in A *Terra/Wattel European Tax Law*, eds. Peter Wattel, Otto Mares & Hein Vermeulen (Deventer: Wolters Kluwer, 2018), p. 35
[51] Ibid, p. 51
[52] 12. Adolfo Martin Jimenez, "Controversial Issues About the Concept of Tax in Income and Capital Tax Treaties in the Post-BEPS World", in *Tax Treaties After the BEPS Projects: A tribute to Jacques Sasseville*, ed. Brian J. Arnold (Toronto: Canadian Tax Foundation, 2018), p. 176.
[53] Ibid, p. 176.

all kinds of public levies that have a contributory nature rather than retributive nature[54]. The case law of the CJEU has reinforced the idea of a broad conceptualization of tax that ultimately serves as a harmonizing tool to include as many levies as possible within the scope of EU law. This means that while MS taxes are mostly applied to share the burden of public expenses based on different principles, like the ability to pay, for EU law taxes are a tool to ensure EU law is applied uniformly[55]. Therefore, some contributions under domestic law that are not considered taxes, might be considered as such by EU law.

With regards to the Spanish solidarity contribution, it would be considered a tax under EU law. It is an obligation to pay for energy corporations which in the case of failure will face enforcement procedures by the national tax authorities. Moreover, as shown in the previous chapter, the tax revenue of the levies will be used for objectives deemed to be of public interest as established by the EU. The levy is of a contributively character as it was designed to ease the energy crisis by taxing those benefitting from the high energy prices. Thus, under a formalistic view of the effect of taxes in the internal market, windfall profit taxes would be seen as an obstacle.

### 2.3.2 Principle of Non-Discrimination

In the last decades, the court has moved away from viewing taxes as an obstacle, being the reason for this change is that the court has understood that applying an obstacle approach to taxation would mean all national tax measures would be prohibited, which would interfere with MS fiscal sovereignty[56]. For that reason, the court has started analysing whether taxes are discriminatory instead of market obstacles, and hence prohibited under the freedoms [57]. The concept of discrimination was defined in the early *Klöckner* case, in which the court ruled that discrimination is treating similar cases differently, subjecting some to disadvantages as opposed to others, without the differentiation being justified on substantial objective differences[58]. Following the *Italian Refrigerators* case, it became clear that discrimination means treating comparable situations differently or different situations alike[59], a principle that has been enshrined in Article 18 TFEU prohibiting discrimination on the grounds of nationality.

In direct taxation, discrimination usually happens on the basis of residency, which in an indirect proxy for nationality. Discrimination can stem from a tax provision of a MS national tax

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[54] Ibid, p. 176.
[55] Pietro Selicato, "The notion of tax and the elimination of international double taxation or double non taxation*", IFA Cahiers* (2016), p. 79.
[56] Peter Wattel, Non-Discrimination à la Cour: The ECJ's (lack of) Comparability Analysis in Direct Tax cases, *European Taxation* 55, no. 12 (November 2015), pp. 542-543.
[57]Ibid, p. 542.
[58] Joined cases 17/61 & 20/61, *Klöckner-Werke AG and Hoesch AG v High Authority of the European Coal and Steel Community*, EU:C:1962:30, [1962], p. 345.
[59] Case C-13/63, *Italian Republic v Commission of the European Economic Community*, EU:C:1963:20, [1963], p. 175.

system, or a tax treaty concluded by an MS that subject non-resident taxpayers from another MS to a less favourable treatment compared to resident taxpayers[60]. Normally non-residents and residents are not in the same tax position because the allocation of taxing rights is done simultaneously under the principle of source and worldwide taxation. Lack of information and income division percentage leads source states to treat non-residents differently[61]. This fact was acknowledged by the ECJ in the *Schumacker* case, in which the court accepted that residents and non-residents are not as a rule comparable, but when they are they should be treated equally[62]. The analysis of less favourable treatment indicating discrimination, examines the overall monetary effects of the measure where no minimis rule exists, even a minor cash flow is sufficient[63]. More recently, the court expressed in the *Vodafone Hungary* case that testing discrimination in direct taxation is not about the particular effects of the measure, but rather the criterion should be whether there is intrinsic discrimination based on residency[64].

Persons affected by discrimination in direct taxation, since the effects of Article 18 are limited, can seek protection under the fundamental freedoms. In order to exercise their right, they have to be within the ambit of the provisions as treaty standing relies on two tests, there needs to be an intra-EU cross border element and there must be capacity (frontier worker, undertaking, investor, etc)[65]. Moreover, except for the free movement of persons due to the introduction of EU citizenship in 1993, the provisions are applicable only in the existence of an economic nexus, for legal persons this is seen as commercial activity[66]. In matters of direct taxation, the court rulings have given ample treaty access for economic operators, unless there is an abuse of the freedoms in the form of an artificial abusive arrangement[67]. The court, however, cannot provide protection in cases where the tax impediment is caused by the non-discriminatory exercise of parallel taxing jurisdictions and thus, the measure is outside of the scope of the treaty freedoms. The court has ruled repeatedly that the freedoms do not require MS to adapt their taxation to other MS tax systems, nor guarantee a neutral tax treatment caused by the differences, called disparities, between legal systems[68].In other words,

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[60] Marjaana Helminen, *EU Tax Law Direct Taxation* (Amsterdam: IBFD, 2022), p. 84
[61] Peter Wattel, Non-Discrimination à la Cour: The ECJ's (lack of) Comparability Analysis in Direct Tax cases, *European Taxation* 55, no. 12 (November 2015), p. 548.
[62] Case C-279/93, *Finanzamt Köln-Alstadt v Roland Schumacker*, EU:C:1995:31, [1995], para. 31.
[63] Niels Bammens & Frans Vaninstendael, "Global Tax Treaty Commentaries: Article 24: Non-Discrimination", *IBFD* (January 2016), para. 4.4.2.2.
[64] Sven Nieuweboer, "Digital Services Taxes: Are They Discriminatory in the Context of the Fundamental Freedoms?", *European Taxation* 65, no. 5 (April 2022), pp. 204-205.
[65] 3. Peter Wattel, "General EU Law Concepts and Tax Law", in A *Terra/Wattel European Tax Law*, ed. Peter Wattel, Otto Mares & Hein Vermeulen (Deventer: Wolters Kluwer, 2018), p. 27
[66] Marjaana Helminen, *EU Tax Law Direct Taxation* (Amsterdam: IBFD, 2022), p. 79
[67] 3. Peter Wattel, "General EU Law Concepts and Tax Law", in A *Terra/Wattel European Tax Law*, ed. Peter Wattel, Otto Mares & Hein Vermeulen (Deventer: Wolters Kluwer, 2018), p. 31
[68] Ibid, pp. 51-53.

persons are almost completely protected by the freedoms in cases of discrimination in direct tax, unless they are created by disparities.

### 2.3.3 The Rule of Reason

The CJEU has developed a systematic step by step analysis to find discrimination, which will be used in the thesis, called the "the rule of reason" doctrine. The concept, first developed in the *Casiss de Dijon* case, expresses that those national measures restricting the freedoms aimed at protecting a legitimate public interest without going any further than necessary, can be deemed acceptable under the treaties[69]. The rule of reason test in direct taxation, as described by Wattel, consists of four steps: a two-step comparability test, a justification test, and a proportionality test.

> (1a) Does the national tax measure *prima facie* distinguish between cross border investment/work/establishment and comparable domestic investment/establishment/work?
>
> (1b) Is there an objective difference between the cross-border and the internal case which explains the different tax treatment of the cross-border case? Are the two positions still comparable viewed in the light of *object and purpose* of the impugned tax measure?
>
> (2) Is there a mandatory requirement of public interest (*a legitimate aim*) justifying the discriminatory measure, e.g. curbing abuse, safeguarding tax base integrity, or ensuring fiscal supervision? If so,
>
> (3) Are the restrictive effects of the discriminatory, but justifiable tax measure *proportionate* to its legitimate aim?[70]

The first question of the rule of reason analysis looks at whether prima facie there is a difference between the domestic and the cross-border situation, which even though is normally present in direct taxation, is not discriminatory as residents and non-residents are not as a rule comparable[71]. The second question aims to see if the actual purpose of the tax measure would make residents and non-residents comparable. Although the court has never established a comparison criterion, primarily the court uses being subject to tax, which is seen as the exercise of assumed taxing jurisdiction over the cross-border situation, as the yardstick to assess comparability[72]. In other words, the cross border and domestic situation will be comparable if they are within the taxing power of the MS. For that reason, non-residents may not be subject to a wider tax base than residents and non-foreign income cannot be taxed less favourably. The measure might, however, still be deemed

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[69] Niels Bammens & Frans Vaninstendael, "Global Tax Treaty Commentaries: Article 24: Non-Discrimination", *IBFD* (January 2016), para. 4.3.3

[70] 14. Peter Wattel, "Conceptual Background of the CJEU Case Law in Direct Tax Matters", in *Terra/Wattel European Tax Law,* eds. Peter Wattel, Otto Marres & Hein Vermeulen (Deventer: Wolters Kluwer, 2018), p. 322.

[71] Ibid, p. 320

[72] Ibid, p. 324.

objectively not comparable in instances where the measure aims to prevent base erosion and profit shifting in cross border situations[73].

The EU windfall profits tax can illustrate how the comparability analysis works. Normally, harmonizing a tax measure at the EU level implies that any possibility of discrimination between tax residents and non-residents would be eliminated, as European institutions would not devise legislation contrary to the fundamental freedoms. Hypothetically, a legal entity conducting business activities in a cross-border situation within the internal market would have access to the fundamental freedoms to challenge the legality of the windfall profits tax. The first step of the comparability analysis would show that indeed prima facie non-residents and residents are not comparable. National rules consider taxable profits for residents any income derived worldwide, while non-residents taxable profits would be income derived only in the MS. Thus, there would be a distinction on how the windfall profits tax is applied to both taxpayers, but since they are not in comparable situations no discrimination would exist. Nevertheless, considering the object and purpose of the windfall profits tax, residents and non-residents are in comparable situations as they are both subject to tax in a certain MS. Observing closely, non-residents are not subject to a wider tax base plus the same tax rate applies as resident taxpayers, hence, non-resident taxpayers are not treated less favourably. In other words, similar situations are treated alike, and discrimination does not exist.

Despite the clear approach of the comparability test, the court has struggled to apply the object and purpose test (1b) mixing it up with the justification test (2). This has resulted in a large body of inconsistent and confusing case law[74]. Some cases of prima facie disadvantage were not considered discrimination by the court due to lack of comparability of the cross border and domestic situation. For instance, in the *Test Claimants* case, the court ruled that according to the objective of the imputation system, non-resident shareholders are not objectively comparable to resident shareholders, since the former are not subject to domestic income tax on the dividends compared to the latter[75]. However, in other cases like *X-Holding*, the court after having considered a tax measure objectively discriminatory, argued it was justified as the cross-border situation was not subject to tax[76]. Therefore, the comparability criterion being subject to tax has been used by the court interchangeably as "objective incomparability" or "justification" in cases where there is no discrimination at all. This thesis, however, agrees with the approach taken in *Test Claimants*, meaning that if non-residents are not subject to tax, they are not in comparable situations.

[73] Ibid, p. 325.
[74] Peter Wattel, "Non-Discrimination à la Cour: The ECJ's (lack of) Comparability Analysis in Direct Tax cases", *European Taxation* 55, no. 12 (November 2015), p. 553.
[75] Ibid, pp. 545-546
[76] Ibid, p. 548

The court has rejected all but one justification in direct taxation that would justify a discriminatory tax measure, which is the protection of the tax base integrity. Among the justifications commonly used by MS to justify a less favourable treatment of non-residents are, for instance, fiscal coherence or the balanced allocation of taxing powers[77]. The court, however, has become stricter in recent years, and thus MS need to prove the relevance of the measure and direct link of the tax with the offset of the advantage non-residents possess[78]. The final step of the rule of reason is examining the proportionality of the measure. The concept of proportionality, contained in Article 5(4) TEU, states that "the content and form of Union action shall not exceed what is necessary to achieve the objectives of the Treaties"[79]. For national tax measures, this test is the biggest hurdle as most of the time justifiable measures are not suited for the purpose or have an extremely restrictive effect on the internal market[80]. In general, any measure that systematically affects cases where fiscal coherence or abuse is at stake and measures that are ineffective, will be considered disproportionate, and hence rejected by the court[81].

### 2.3.4 Discrimination Analysis of the Spanish Solidarity Contribution

Given the conceptualization of discrimination in direct taxation seen above, the key issue to explore in order to answer sub-question two, which looks at the compatibility of the Spanish solidarity contribution with the fundamental freedoms, is whether the tax differentiates between residents and non-residents in comparable situations. For that reason, the rule of reason doctrine will be applied.

The first step to take to examine if the Spanish solidarity contribution could lead to discrimination is finding if there is distinction prima facie of residents and non-residents. Although the Spanish law does not explicitly mention PE or non-residents taxpayers, it is assumed the solidarity contribution similarly applies to non-residents carrying at least 75% of their activities in the oil industry within Spain. In their explanation of a PE, the Spanish tax authorities clarify that mines, petroleum or gas wells and quarries, are considered sufficient to establish a PE, and thus trigger source taxation within Spain[82]. Therefore, the contribution applies to any legal entity carrying activities in the energy sector no matter their residency status.

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[77] 14. Peter Wattel, "Conceptual Background of the CJEU Case Law in Direct Tax Matters", in *Terra/Wattel European Tax Law*, eds. Peter Wattel, Otto Marres & Hein Vermeulen (Deventer: Wolters Kluwer, 2018), p. 326.
[78] Giampaolo Gente, "Dividends Received by Investment Funds: An EU Law Perspective", *European Taxation* 53, no. 2/3 (February 2013), para. 5.3.3
[79] Consolidated version of the Treaty on European Union (2002), *Official Journal* C325/5, Art. 5(4), p. 18.
[80] 3. Peter Wattel, "General EU Law Concepts and Tax Law", in A *Terra/Wattel European Tax Law*, ed. Peter Wattel, Otto Mares & Hein Vermeulen (Deventer: Wolters Kluwer, 2018), pp. 42-43.
[81] 14. Peter Wattel, "Conceptual Background of the CJEU Case Law in Direct Tax Matters", in *Terra/Wattel European Tax Law*, eds. Peter Wattel, Otto Marres & Hein Vermeulen (Deventer: Wolters Kluwer, 2018), p. 328.
[82] "Definition of permanent establishment", *Agencia Tributaria*, October 8, 2021, https://sede.agenciatributaria.gob.es/Sede/en_gb/no-residentes/irnr-establecimiento-permanente/definicion-establecimiento-permanente.html

Non-resident legal entities could invoke access to the fundamental freedoms in their capacity as EU undertakings carrying business activities in a cross-border situation and with an economic nexus in Spain. They could, thus, challenge the contribution on grounds of discrimination. Normally, non-residents and residents are not in comparable situations as the former is taxed on source income while the latter is taxed on worldwide income. However, the solidarity contribution is not based on income, but rather the taxable base is net sales calculated as all the sales carried out within Spain minus any deductions. In other words, all the taxpayers are subject to source taxation and any sales deriving from another country will not be considered for the calculation of the taxable base. Moreover, legal entities are all subject to the same applicable tax rate. Thus, residents and non-residents are subject to tax in the same manner, meaning both groups of taxpayers are in comparable situations and prima facie there is no distinction between them.

Since we have already established that there is no distinction between the treatment of residents and non-residents without having to look at the object and purpose of the rule, it can be concluded from the rule of reason analysis that no discrimination exists, and no further step would be required. The analysis of the Spanish solidarity contribution suggests that the levy is not contrary to the fundamental freedoms as non-residents are not treated less favourably. Nonetheless, the analysis does not show if national residents are treated less favourably than non-residents which could lead to a case of reverse discrimination. Given that the Spanish solidarity contribution was designed earlier than the EU regulation and its main scope are principal operators in the energy market, it could be plausible that residents have a less favourable treatment than non-residents.

### 2.4 The Phenomenon of Reverse Discrimination

Reverse discrimination is a by-product of measures taken by MS aimed at creating and fostering the aims of the internal market, in which due to over-compliance with primary EU law, the MS protects other states' nationals to the detriment of their own nationals[83]. As a result, the MS creates an environment where the exercise of the fundamental freedoms becomes more attractive to secure a more favourable treatment than the one applying domestically[84]. Reverse discrimination is, thus, defined as applying "a less favourable treatment to own nationals of the State than to foreigners or to nationals of that State that have de facto exercised their freedom to move"[85]. The idea behind reverse discrimination is that the group expected to be treated more favourably, as States will always try to protect their own nationals, suddenly become treated worse due to overcompensation for a

[83] Pedro Vidal Matos, "Reverse Discrimination and Direct Taxation in the EU", *Instituto Superior de Gestao*, (2010), p. 46
[84] Pasquale Pistone, "The Impact of ECJ Case Law on National Taxation", *Bulletin for International Taxation* 64, no. 8/9 (June 2010), p. 421
[85] Daniela Garcia, "Are There Reasons to Convert Reverse Discrimination into a Prohibited Measure?", *EC Tax Review*, no. 4 (2009), p. 180.

disadvantage suffered traditionally by another group, non-nationals[86]. A higher degree of reverse discrimination cases is bound to happen in those areas where there is EU harmonization, which is not the case in the field of direct taxation[87].

Nationals of a MS searching for protection under the fundamental freedoms against reverse discrimination, need to be within the scope of the treaty, namely the discrimination entails the hindrance of the internal market by obstructing cross border activities[88]. The delimitation of the scope of application of the treaties has been developed by the ECJ in the doctrine of "purely internal situations", first used in the *Saunders* case[89]. The court ruled that the freedoms do not apply to wholly internal situations caused by national law, with no factor connecting them to Community law[90]. For that reason, the court has repeatedly stated that reverse discrimination does not fall within the scope of the fundamental freedoms, and it is hence in principle permissible under EU law. This argumentation position was already used early in the *Mathot* case where the court stated that the purpose of the free movement of goods is not ensuring that national products always enjoy the same treatment as imported goods[91]. In direct taxation cases, since MS have retained fiscal competence, the court has always deemed the tax treatment of nationals as a purely internal situation and has frequently affirmed that MS shall deal with reverse discrimination within the domestic tax legal framework, if considered necessary. Moreover, the CJEU has avoided explicitly stating whether reverse discrimination is prohibited by the fundamental freedoms even when national courts have directly asked the court for clarification, as seen in the case *Acereda Herrera*[92]. Therefore, under EU law, reverse discrimination in direct taxation is in general an acceptable phenomenon.

In the area of direct taxation, there are two groups of persons that can be affected by reverse discrimination, national residents, and national non-residents[93]. The latter group involves cases of nationals who might suffer a less advantageous tax treatment by their own MS due to wanting to exercise their EU freedoms instead of restricting their actions to their home territory[94]. The CJEU has clarified that the home state should not make cross board activities less attractive than conducting

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[86] Alina Tryfonidou, "Purely Internal Situations and Reverse Discrimination in a Citizens Europe: Time to "Reverse" Reverse Discrimination?", *Legal Issues of Economic Integration* 35, no. 1(February 2008), pp. 12-15.
[87] Pedro Vidal Matos, "Reverse Discrimination and Direct Taxation in the EU", *Instituto Superior de Gestao*, (2010), p.
[88] Alina Tryfonidou, "Purely Internal Situations and Reverse Discrimination in a Citizens Europe: Time to "Reverse" Reverse Discrimination?", Legal Issues of Economic Integration 35, no. 1(February 2008), pp. 12-15.
[89] Pedro Vidal Matos, "Reverse Discrimination and Direct Taxation in the EU", *Instituto Superior de Gestao*, (2010), p.
[90] Case C-175/78, *La Reine v. Vera Ann Saunders*, EU:C:1979:88, [1979], para. 11.
[91] Case C-98/96, *Mathot*, EU:C:1987:89, [1987], para. 9.
[92] Case C-466/04, *Acereda Herrera*, EU:C:2006:405, [2006], para. 46-51.
[93] Daniela Garcia, "Are There Reasons to Convert Reverse Discrimination into a Prohibited Measure?", *EC Tax Review*, no. 4 (2009), p.
[94] Pedro Vidal Matos, "Reverse Discrimination and Direct Taxation in the EU", *Instituto Superior de Gestao*, (2010), p.

activities solely domestically[95]. In this case, it does not matter whether the person ever has the intention of exercising their EU rights, they are not deprived of them in the absence of a cross border movement. A good example of a discrimination prohibition in the state of origin is the exceptional decision taken by the ECJ in the *Marks Spencer* case. The ECJ ruled that to protect the freedom of establishment, foreign final losses should be deductible in the EU country where the parent company is established in case the subsidiary country does not provide relief[96]. The decision forced MS to exercise their tax jurisdiction asymmetrically, since foreign profits are not taxable, meaning the court overstepped MS sovereignty. The conclusion derived from the judgement is that MS cannot take measures that would deter own nationals from exercising EU rights.

Reverse discrimination against national non-residents, as shown above, has been sometimes considered contrary to EU law and thus prohibited in exceptional cases like *Marks Spencer*. Nevertheless, reverse discrimination still exists against national residents of MS in the field of direct taxation. Worth mentioning is the non-tax *Flemish* case in which a care insurance scheme for disabled people originally only covered persons residing in the Dutch speaking region and Brussels, which was challenged by the commission on grounds of free movement of persons[97]. Of interest is the analysis made by the court to decide what type of reverse discrimination was acceptable by dividing people affected in three categories. The first group was Belgian nationals working in the Dutch area that had never exercised their EU freedoms but residing in another region of Belgium[98]. Secondly, nationals of other MS working in the qualifying area living in another part of Belgium[99]. Thirdly, Belgian nationals working in the area, leaving in another part of the territory but who had exercised their right to freedom of movement[100]. The court decided groups number two and three were within the scope of the Community law, while group number one, national residents, were not[101]. The judgement created a paradoxical situation in which free movement was guaranteed between EU countries but not within Belgian regions.

Legal scholars are increasingly challenging the reasoning of purely internal situations and demanding the court to resolve this paradox[102]. In her opinion of the Flemish case, Advocate General Sharpston argued that reverse discrimination is hard to reconcile with the notion of EU citizenship,

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[95] 3. Ivan Lazarov, "The Relevance of the Fundamental Freedoms for Direct Taxation" *in Introduction to European Tax Law on Direct Taxation*, ed. Lang et al. (Spiramus Press, 2020), pp. 73-74
[96] Case C-446/03, *Marks & Spencer plc*, EU:C:2005:763, [2005], para. 56.
[97] Case C-216/06, *Government of the French Community and Walloon Government v Flemish Government*, EU:C:2008:178, [2008], para. 7-12.
[98] Ibid, para. 37-38
[99] Ibid, para. 41-42
[100] Ibid, para. 44
[101] Ibid, para. 37-54
[102] 7. Peter van Elsuwege, "The Phenomenon of Reverse Discrimination: An Anomaly in the European Constitutional Order?", in *The EU after Lisbon*, eds. Rossi & Casolari (Switerzland: Springer International Publishing, 2004), p. 162.

which renders the distinction between cross border and purely internal situations wholly artificial[103]. Similarly, Advocate General Mischo in the *Edah* case has already declared that "reverse discrimination is clearly impossible in the long run within a true common market, which must of necessity be based on equal treatment"[104]. The court, despite the increased pressure on solving all kinds of reverse discrimination, has refused to change its doctrine. For instance, they noted in the *Uecker & Jacket* case that EU citizenship does not alter the scope of the treaties *ratione materiae*, and hence, the aims of the treaty of ensuring the functioning of the internal market remains untouched[105].

To conclude with, instances of reverse discrimination in direct taxation, or other fields, might be solved by the CJEU for non-resident nationals under the protection of the fundamental freedoms, yet national residents will be unprotected by EU law.

### 2.4.1 Reverse Discrimination Analysis of the Spanish Solidarity Contribution

The implementation of the Spanish solidarity contribution could lead to reverse discrimination if it affects national residents disproportionately compared with non-residents. The previous analysis of the contribution done in Chapter 4 already showed that residents and non-residents are subject to the same taxable base and tax rate, and thus there is no discriminatory distinction among them. Nevertheless, the scope of the tax, principal operators in the energy market as defined by Spanish law with more than 1.000 million net sales in 2019 and more than 50% of earnings derived from energy in 2017/18/19, indicates that the main target group of the levy might be resident energy corporations.

The most recent resolution by the National Commission of Markets and Competition, as shown in Table 1, shows the five principal operators segregated by energy sectors[106]. After looking at the net sales of the entities in 2019, all principal operators are within the scope of the tax but three; Acciona SA is not included as they do not derive more than 28% of earnings from energy activities, and both Peninsula Petroleum and Disa Corporación Petrolífera do not surpass the net sales threshold. Under Spanish law, you are considered a resident taxpayer if the entity is incorporated in Spain, has a registered address, or has its effective head office, measured as management and control of the firm, in Spanish territory[107]. Remarkably, all the principal operators affected are incorporated entities

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[103] Opinion of Advocate General Sharpston, Case C-212/06, *Government of the French Community and Walloon Government v Flemish Government*, EU:C:2008:178, [2008]
[104] Opinion of Advocate General Mischo, Joint Cases C-80/85 & C-159/85, *Nederlandse Bakkerih Stichting and others v Edah BV*, EU:C:1986:426, [1986]
[105] Joined cases C-64/96 & C-65/96, *Land Nordrein-Westfalen v Kari Uecker and Vera Jacket v Land NordrheinWestfalen*, EU:C:1997:285, [1997], para. 23.
[106] Resolución de 24 de noviembre de 2022, de la Comisión Nacional de los Mercados y de la Competencia", *BOE* no. 302, BOE-A-2022-175179.
[107] "Legal person resident in Spain", *Agencia Tributaria*, February 16, 2023, https://sede.agenciatributaria.gob.es/Sede/en_gb/no-residentes/residencia-personas-fisicas-juridicas/persona-juridica-residente-espana.html

according to Spanish law as they are "Sociedades Anónimas" or "Sociedades Limitadas" which are different types of commercial legal entities. Therefore, all the principal operators are tax residents in Spain.

**Table 2**

| *Principal Operators of the Energy Sector* | | | |
|---|---|---|---|
| *Electric Sector* | *Natural Gas Sector* | *Fuel Sector* | *LGP Sector* |
| Endesa, SA[108] | Naturgy Energy Group, SA | Repsol, SA | Repsol, SA |
| Iberdrola, SA[109] | Endesa, SA | Compañía Española de Petróleos, SA (CEPSA) | Compañía Española de Petróleos, SA (CEPSA) |
| Naturgy Energy Group, SA[110] | Repsol, SA[111] | BP España, SAU[112] | BP España, SAU |
| EDP Energías SA[113] | Iberdrola, SA | Petronieves, SL[114] | Naturgy Energy Group, SA |
| Acciona, SA[115] | Compañía Española de Petróleos, SA (CEPSA)[116] | Península Petroleum, SL[117] | Disa Corporación Petrolífera, SA[118] |

[108] The net sales for Endesa SA in their financial report audited by the CNMV in 2019 was 2.137 million euros. https://www.cnmv.es/AUDITA/2019/18298.pdf

[109] The net sales for Iberdrola SA and its subsidiaries as stipulated in their consolidated accounts for 2019 was 36.437.908 million euros. https://www.iberdrola.com/documents/20125/42361/jga20_IA_CuentasAnualesConsolidadas2019_Acc.pdf

[110] The net sales for Naturgy Energy Group SA as reported in their financial accounts for 2019 was 23.035 million euros. https://www.naturgy.com/en/files/Naturgy_Energy_Group_SA_eng.pdf

[111] The net sales for Repsol SA in 2019 was 6.090 million euros as stipulated in their annual report. https://www.repsol.com/imagenes/global/es/OIR_200220_informe_financiero_anual_2019_tcm13-174953.pdf

[112] The net sales for BP España during the year of 2019 it was 6.561 million euros as reported in their non-financial report. https://www.bp.com/content/dam/bp/country-sites/es_es/spain/home/pdfs/comunidad/estado-de-informacion-no-financiera-2019.pdf

[113] EDP Energías SA had net sales in their financial account of 2019 of 1.642 million euros https://www.edpr.com/sites/edpr/files/2020-09/EDPR_InformeAnual2019.pdf

[114] The net sales for Petronieves SL in 2019 was 1.504 million euros. https://www.expansion.com/catalunya/2020/12/29/5feb8f35468aeb131f8b45d0.html

[115] The net sales of Acciona SA was 7.190 million euros in 2019 as shown in the consolidated accounts. Their energy activities do not constitute more than 50% of their operations. For instance, in 2019 it was only a 27.8% of the net sales (cifra de negocios total energia / cifra de negocios total grupo = 1.997.185/7.190.589). https://accionacorp.blob.core.windows.net/media/3541190/cuentas-consolidadas-2019.pdf

[116] The net revenue for CEPSA in 2019 according to their financial accounts was 1,445.956 million euros. https://www.cepsa.com/stfls/corporativo/FICHEROS/CEPSA_CCAA_2019.pdf

[117] The net sales in 2019 for Peninsula Petroleum was 966 million euros. https://ranking-empresas.eleconomista.es/PENINSULA-PETROLEUM.html

[118] The net sales of Disa Corporación Petrolífera for 2019 were 79 million euros. https://www.libertaddigital.com/empresas/disa/

Given the definition of residency in Spain is extremely broad, any legal entity doing either B2B or B2C sales in the energy market in Spain would most likely trigger tax residency. Moreover, it has been documented that whenever a legal entity only meets the third condition for tax residency, effective place of management, due to the lack of clear guidelines enshrined in legislation, Spanish tax courts tend to tailor their approach to each case[119]. Sometimes, the courts have taken a formal approach by for instance looking at where the management body meetings took place, and other times they have taken a finality-based approach that looks at events like where the local strategy is defined[120]. As a result, the Spanish courts can establish tax residency for most legal entities, ultimately allocating taxing powers to Spain. Furthermore, Spain has a negligible production of oil or gas and is completely dependent on imports[121]. The oil and gas infrastructure is managed by two big Spanish entities, the refinery production is owned by Repsol, CEPSA and BP, and there are no more active coal mines in Spain[122]. In other words, the fossil fuel sector is dominated by Spanish companies and the probability of the existence of PEs from foreign companies is low. This together with the fact that the clear aim of the tax was primarily taxing principal operators, as the inclusion of legal entities with 75% of business in the fossil fuel sector was added post hoc after the EU regulation came into force, means that the chance non-residents will be affected by the contribution is slim. In other words, residents are disproportionately affected by the levy.

Despite residents mainly being affected by the levy, the question remains on whether the Spanish contribution actually leads to reverse discrimination, which is treating residents less favourably than non-residents. On the one hand, from a formal approach, there is no reverse discrimination as the letter of the law includes residents and non-residents equally within the scope of the tax. On the other hand, from a substance approach, resident companies are the main target and clearly the most affected by the contribution. From this stance, it could be argued that Spain has made exercising the fundamental freedoms by conducting business abroad more attractive than staying within domestic frontiers. However, non-residents, even though the EU windfall profits tax on a priori seems less burdensome than the Spanish levy, will still be subject to the tax on their windfall profits in their residency country. Moreover, the particular effects the measure has on residents do not show that there is intrinsic reverse discrimination at the core of the Spanish tax. For that reason, the approach of this thesis is that the Spanish solidarity contribution does not lead to reverse discrimination.

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[119] Frank P.G. Pötgens et. al., "The Impact of a Corporate Governance Systems on the Place of Effective Management Concept in Spain, France, the United Kingdom, the Netherlands, Germany and Italy", *European Taxation* 9, vol. 54 (August 2014), p. 5

[120] Ibid, p. 6

[121] International Energy Agency, "Spain Oil Security", *IEA ORG* (June 2022), Accessed May 13 2023, https://www.iea.org/articles/spain-oil-security-policy

[122] International Energy Agency, "Spain Natural Ga Security Policy", *IEA ORG* (June 2022), Accessed May 13 2023, https://www.iea.org/articles/spain-natural-gas-security-policy

Even if the principal operators in Table 1 would try to appeal the tax on the basis of the fundamental freedoms, they would not be within the scope of the treaty due to a lack of cross border activities. Since the contribution does not hinder the internal market, if the CJEU would be confronted with this case, it would apply the "purely internal situation" doctrine, as seen for instance in the *Flemish* case. As MS are competent in fiscal matters, the court would most likely state that Spanish national courts should deal with the "discriminatory" effects of the tax within the boundaries of domestic law. This outcome is logical, as the court has repeatedly said that reverse discrimination is not prohibited by the fundamental freedoms in direct taxation, making it an acceptable phenomenon under EU law. For that reason, some of the principal operators like Repsol have challenged the levy on discriminatory grounds within the national courts, based on the argument that it might be unconstitutional to target only certain corporations of the energy sector[123], rather than referring the case based on the fundamental freedoms.

To conclude, the analysis from subsections 2.3.4. and 2.4.1 illustrates that the Spanish solidarity contribution is accordant to the fundamental freedoms as it does not lead to any instance of discrimination, meaning it is not contrary to EU primary law. Therefore, the answer to sub-question two, is that the Spanish contribution is fully compatible with fundamental freedoms contained in the foundational treaties of EU law. After having established that the Spanish levy does not lead to any issues of legality in Chapter 2, Chapter 3 will explore potential issues of legality with the OECD Model Convention.

## Chapter 3: Compatibility of the Spanish Solidarity Contribution with Double Tax Conventions

International juridical double taxation, which is defined by the OECD as "the imposition of comparable taxes in two (or more) States on the same taxpayer in respect of the same subject matter and for identical periods"[124], has long been identified by states as undesirable for international trade. To curb its harmful effects on the movement on goods, services and capital, states have developed an extensive network of tax treaties that lay the foundations for the elimination of double taxation. The OECD Model Tax Convention on Income and on Capital, first developed in 1963, serves as a model that has unified tax treaty rules and it is the basis for many negotiations, applications, and interpretations of tax conventions around the world[125]. Given the unconventionality of the Spanish solidarity contribution, and the theoretical principles behind taxing windfall profits, the

[123] Pierre Lomba, "La Audencia Nacional rechaza las medidas cautelares solicitadas por Repsol contra el impuesto a las energéticas", *El País* (February 2023), https://elpais.com/economia/2023-02-17/la-audiencia-nacional-rechaza-las-medidas-cautelares-solicitadas-por-repsol-contra-el-impuesto-a-las-energeticas.html
[124] OECD, "Model Tax Convention on Income and on Capital: Condensed Version 2017", *OECD Publishing* (November 2017), p. I-1
[125] Ibid, p. I-4

implementation of the levy poses a serious threat of double taxation. Therefore, the main issue regarding this tax, is whether is within the scope of the Convention and thus suitable to receive relief for double taxation.

### 3.1 Article 2 of the OECD Model Tax Convention

The concept of "tax" is fundamental in the tax treaty system, as the ultimate goal of the model is to compare taxes to eliminate double taxation. Article 2 of the model, which establishes the scope of the model, defines taxes on income and capital to which tax treaties apply. The function of Article 2 is foundational as double taxation will only be eliminated if the tax in question is covered by the article[126]. The article, moreover, establishes a two-way approach to the comparison of taxes, consisting of two first paragraphs with a general definition of taxes covered and two last paragraphs with a specific list of taxes and an ambulatory clause[127]. Therefore, Article 2 is the gateway to receiving the protection of tax treaties by limiting source taxation, and ultimately being granted relief.

Article 2 of the model, which has not been substantially changed since the 1960s while the international tax system has become more vulnerable and complex, reads as follows;

1. "This convention shall apply to taxes on income and on capital imposed on behalf of a Contracting State or of its political subdivisions or local authorities, irrespective of the manner in which they are levied.
2. There shall be regarded as taxes on income and on capital all taxes imposed on total income, on total capital, or on elements of income or of capital, […].
3. The existing taxes to which the Convention shall apply are in particular:
    a. (in State A): …
    b. (in State B): …
4. The Convention shall apply also to identical or substantially similar taxes that are imposed after the date of signature of the Convention in addition to, or in place of, the existing taxes. The competent authorities of the Contracting States shall notify each other of any significant changes that have been made in their taxation laws."[128]

Despite the initial simplicity of the wording of the article, the application and interpretation of Article 2 is not without controversy that has resulted in world disputes. A few of the issues with Article 2 are the differing interpretations of the meaning tax on income, the creation of innovative

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[126] Wei Cui, "Article 2 – Taxes Covered – Global Tax Treaty Commentaries", *IBFD* (August 2021), para. 1.1.1.2.
[127] Adolfo J. Martín Jiménez, "Defining the Objective Scope of Income Tax Treaties: The Impact of Other Treaties and EC Law on the Concept of Tax in the OECD Model", *Bulletin for International Fiscal Documentation* 59, no 10 (October 2005), p. 432.
[128] OECD, "Model Tax Convention on Income and on Capital: Condensed Version 2017", *OECD Publishing* (November 2017), p. M-8

taxes that are hard to categorize or the heterogenous implementation of the OECD Model Convention[129].

### 3.1.1 The Term "Tax" in Art. 2(1)

From the wording of Article 2 it is clear that the OECD Model does not specifically define what the general tax term means, nor does it define it on a standalone basis anywhere else within the model. In this situation, some authors have suggested that the term could be defined using the general rule of interpretation contained in Article 3(2)[130]. The provision allows Contracting States to use domestic law, characterized as statutes or case law not necessarily deriving from fiscal law, whenever a term is not defined by the Convention or its context[131]. The concept of tax, thus, would be defined under any relevant domestic provisions, and in the case, domestic law does not provide a satisfactory outcome, the VCLT Convention can be used for support[132]. Attempting to use the general rule of interpretation to define "tax", is seen by the thesis as an erroneous approach as the context does give an indication of what taxes are. Moreover, domestic law rarely defines the term "tax", and in the case it does, it can lead to controversies as some levies can be left out of the definition. Aiming for a wide concept of tax would ensure the widest application of the treaty possible, something domestic law can impede.

Article 2(1) and the commentary, nevertheless, already give an indication of the basic characteristics taxes need to meet to be within the scope of the convention. Firstly, they must be imposed on behalf of a public body[133]. The commentary gives some examples of public bodies ranging from the state to local authorities, which means that only authorities at certain geographical levels are covered[134]. Recently countries have adopted levies that are compulsory with no corresponding direct benefit raised for non-public entities like semi-public bodies[135]. An example of this kind of levy is the Zakat, included by countries like Spain in some of their treaties. Interpreting the first clause strictly would leave these levies out of scope, which in most cases does not make sense as the levies are an obstacle to free trade[136]. For that reason, the first characteristic of taxes should be interpreted broadly, to realistically eliminate double taxation in a fast-changing tax system. Secondly,

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[129] 12. Adolfo Martin Jimenez, "Controversial Issues About the Concept of Tax in Income and Capital Tax Treaties in the Post-BEPS World", in *Tax Treaties After the BEPS Projects: A tribute to Jacques Sasseville*, ed. Brian J. Arnold (Toronto: Canadian Tax Foundation, 2018), p. 168.
[130] Cesare Silvani, "IFA Research Paper: The Notion of tax in Tax Treaties", *International Fiscal Association*, (December 2013), p. 9.
[131] Ibid, pp. 9-10.
[132] Ibid, pp. 9-10.
[133] OECD, "Model Tax Convention on Income and on Capital: Condensed Version 2017", *OECD Publishing* (November 2017), p. M-8.
[134] Ibid, C(2)-1.
[135] Saud M. Aloliby, "Saudi Arabi´s Tax Treaties: What Does Zakat Have to Do with Them?", *Bulletin for International Taxation* 77, no. 3 (December 2022), p. 113.
[136] Ibid, p. 129.

the clause states that the manner in which the tax is levied is irrelevant[137]. In other words, the levies can take the form of a deduction, surtaxes, surcharges, additional taxes, direct assessments, etc[138]. Therefore, similarly to the concept of tax in EU law discussed in Chapter 2.3.1, taxes in the OECD Model are characterised as a mandatory imposition by the authorities paid for the public interest.

Based on this definition, since the windfall profits tax is imposed on behalf of a Contracting State, no matter how it is levied it would be considered a tax. However, windfall profits taxes are imposed in the event of an unforeseen event for a small period, which means they would be characterised as extraordinary taxes. One of the main problems of extraordinary taxes is whether they are covered by a pre-existing treaty. Paragraph 5 of the commentary gives a nuanced view, Contracting States can either restrict the application of the Conventions to ordinary taxes or extend it to extraordinary taxes through special provisions[139]. The confusing wording of the commentary is due to the historical context while drafting Article 2; some countries wanted to exclude extraordinary taxes altogether in separate bilateral treaties, while others did not want to exclude them[140]. However, since the model does not explicitly make a distinction between them, it can be assumed that extraordinary taxes are within the scope unless explicitly excluded[141]. Therefore, any EU windfall profits tax is presumably covered by the OECD model.

### 3.1.2 Taxes on Income in Art. 2(2)

Another potential issue extraordinary taxes might face as an extraordinary tax, is whether it qualifies as a tax on income, as extraordinary taxes might also be exceptional in their design. Since the OECD Model only covers taxes levied either on income or on capital, the windfall profits tax should be levied on income to be within scope.

The second clause of Article 2 has a tautological approach to defining taxes on income since they are defined as taxes on total income. The clause, thus, does not provide guidance to resolve this issue nor does the commentary, and resorting to domestic law would again give an imprecise outcome. Moreover, as Cesare Silvani rightly points out the first and second clause of Article 2 is meant to function independently from domestic law[142]. Economic theory can be the first step to defining income[143]. The Haig-Simons income theory states that income is "the money value of net

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[137] OECD, "Model Tax Convention on Income and on Capital: Condensed Version 2017", *OECD Publishing* (November 2017), p. M-8.
[138] Ibid, C(2)-1.
[139] Michael Lang, "Taxes Covered – What is a "Tax" according to Article 2 of the OECD Model?", *Tax Treaty Monitor*, (June 2005), p. 217.
[140] Ibid, p. 217.
[141] Ibid, p. 217.
[142] Cesare Silvani, IFA Research Paper: The Notion of tax in Tax Treaties", *International Fiscal Association*, (December 2013), pp. 34-37.
[143] Ibid, 34-37.

accretion of one's economic power during a certain period of time"[144]. Some items that are clearly within this definition of income would be annual profits, salaries or dividends. Despite the many economic definitions of income and the popularity of the Haig-Simons theory, there is still a lack of common understanding of what income means in a tax law context[145]. Nevertheless, there are some characteristics that can indicate if an element is considered income. Taxes on income concern flow figures and they tend to cover transfers for full consideration[146]. Moreover, in contrast with turnover taxes, taxes on income focus on the direct net spending power of the taxpayer[147]. The windfall profits tax proposed by the EU regulation, hence, can be seen as a tax on income as it is imposed on net income, considered a flow figure, and captures the spending power of the taxpayer.

### 3.1.3 List of Taxes in Art. 2(3)

Article 2(3) of the OECD model is meant to provide a list of taxes from both contracting states covered by the treaty. Concerns have been raised by scholars on whether the list's nature should be regarded as illustrative or exhaustive. In the Article the expression "in particular" indicates that the list is illustrative since it is used to emphasize some taxes over others without excluding them[148]. The commentary, however, gives a contradictory view on the issue as it states that "the list is not exhaustive […], in principle, however, it will be a complete list of taxes imposed in each State at the time of signature and covered by the Convention"[149]. In other words, the list serves to illustrate the preceding clauses, but given the process of negotiating treaties, it should be complete at the time of signature[150]. Case law in Belgium also indicates that Article 2(3) is not meant to restrict the application of the model, it is meant to inform about the domestic law of the Contracting States[151]. Therefore, in practice the list is exhaustive at the moment it was signed since it is supposed to be complete, yet it remains in principle illustrative. The non-exhaustive nature of the article is in line with a wide application of the Convention this thesis is arguing for.

Sometimes when the treaties are signed there are taxes on income or capital in either state that are not listed. The issue that arises then is whether the third clause can limit the application of the first

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[144] Roland Ismer & Christoph Jescheck, "The substantive Scope of Tax Treaties in a Post-BEPS World: Article 2 OECD MC (Taxes Covered) and the Rise of New Taxes", *Intertax* 45, no. 5 (2017), p. 384.
[145] Cesare Silvani, IFA Research Paper: The Notion of tax in Tax Treaties", *International Fiscal Association*, (December 2013), pp. 34-37.
[146] Roland Ismer & Christoph Jescheck, "The substantive Scope of Tax Treaties in a Post-BEPS World: Article 2 OECD MC (Taxes Covered) and the Rise of New Taxes", *Intertax* 45, no. 5 (2017), p. 384.
[147] Ibid, p. 384.
[148] Michael Lang, "Taxes Covered – What is a "Tax" according to Article 2 of the OECD Model?", *Tax Treaty Monitor*, (June 2005), pp. 220-221.
[149] OECD, "Model Tax Convention on Income and on Capital: Condensed Version 2017", *OECD Publishing* (November 2017), p. C(2)-3.
[150] Cesare Silvani, IFA Research Paper: The Notion of tax in Tax Treaties", *International Fiscal Association*, (December 2013), pp. 49-52.
[151] Wei Cui, "Article 2 – Taxes Covered – Global Tax Treaty Commentaries", *IBFD* (August 2021), para. 5.1.2.1.

two paragraphs of the Convention. Scholars like Lang have argued that negotiators are cautious and thorough in drafting the list, and thus any tax not included in the list that already existed before the treaty, shall not be covered[152]. However, the Working Party No. 30 and the generally accepted view by scholars is that a tax not mentioned in the list if it is a tax covered under paragraphs 2(1) and 2(2), it shall be within the scope of the treaty[153]. Therefore, the first two clauses of Article 2 have the ultimate responsibility of defining the scope of a treaty in this context. States that wish to exclude an existing tax on income or capital should consider omitting both first clauses from the treaty[154]. Notably, treaties with the US only rely on the list of Article 2(3) to express the coverage of the treaty. This approach, nevertheless, results in issues of reconciliation with treaty coverage for new taxes imposed after the treaty[155].

Similar questions of coverage arise when a tax listed in Article 2(3) would not be considered a tax on income or capital under the first two paragraphs. Under the international law pacta sunt servanda principle, which roughly means what has been agreed must be kept, if a tax is listed then it is covered irrespectively of its nature[156]. Most scholars agree with this view which has been named the amplifying power of Article 2(3).

With regards to the EU windfall profits tax regulation, since it was passed in late 2022, any of the new levies designed by MS are not included in the list provided by Article 2(3) of treaties already in force. Due to their temporary nature, even in the event of a treaty being negotiated after the imposition of the tax, it would most likely not be mentioned in the list. Nevertheless, as seen above, not being included in Article 2(3) would not mean the levy is not within the scope of the treaty as it would be covered by the first two clauses of the Convention. Finally, the windfall profits tax would be problematic in states with treaties that have decided to omit the first two clauses, an issue only Article 2(4) can resolve.

### 3.1.4 Similar Taxes in Art. 2(4)

The purpose of Article 2(4) is to guarantee automatic treaty coverage for any tax imposed after the date of signature that is identical or substantially similar to existing taxes. The list of taxes in Article 2(3) serves as a benchmark to extend treaty coverage. Thus, the fourth paragraph is essentially an extension provision that can affect two groups of taxes, either pre-existing taxes that have been materially modified, or to complete new taxes.

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[152] Michael Lang, "Taxes Covered – What is a "Tax" according to Article 2 of the OECD Model?", *Tax Treaty Monitor*, (June 2005), pp. 220-221.
[153] Mario Tenore, "Taxes Covered: The OECD Model (2010) versus EU Directives", *Bulleting for International Taxation* 66, no. 6 (April 2012), pp. 4-5.
[154] Wei Cui, "Article 2 – Taxes Covered – Global Tax Treaty Commentaries", *IBFD* (August 2021), para. 5.1.2.
[155] Ibid, para. 5.1.2.
[156] Mario Tenore, "Taxes Covered: The OECD Model (2010) versus EU Directives", *Bulleting for International Taxation* 66, no. 6 (April 2012), pp. 4-5.

For the first group, the main question to answer is whether the reference to a specific tax in Article 2(3) is static, meaning it only applies to how the tax looks at the moment of signing, or ambulatory, meaning it applies to the tax with subsequent amendments[157]. The Federal Court of Australia adopted an ambulatory approach arguing that a reference to a statute even if amended, as long as it is in force and covered under the list, the tax would be automatically included[158]. In contrast, other legal scholars argue that the list is static as it reflects the domestic law of the Contracting States when the treaty was signed[159]. Furthermore, if the list was not static it would mean that states can take unilateral action ultimately jeopardizing the treaty by substantially changing a tax without modifying the name[160]. As a result, since it would be considered already within the scope under Article 2(3), the modified tax would be automatically covered without having to undergo a comparability analysis as stipulated by Article 2(4)[161]. This situation could be considered an abuse of the treaty, therefore, accordingly to a static view, for modified pre-existing taxes a substance over form analysis should be conducted under Article 2(4).

There are two approaches to compare the new tax, regardless of whether it is imposed in addition to or in place of an existing tax, the micro approach and the macro approach[162]. The first identifies one single tax the new levy is similar to and compares both parallel to each other[163]. The second approach compares the new levy to all the taxes listed in Article 2(3), meaning the likelihood of finding a match increases by providing a wider treaty coverage compared to the first method[164]. Despite the method chosen, it should be a comprehensive comparison as formal aspects like the name or the rate of the levy should not play a role[165]. Elements to analyse, thus, could be the tax subject and object, the purpose of the tax, or calculation of the tax base. The UK court in the *Bricoms Holdings* case stated that the most important element to take into account is the tax base[166]. In practice, however, there is no consensus on what substantially similar means or what elements of the new tax are relevant, meaning every country follows its own approach. Overall, any new identical or

[157] Cesare Silvani, IFA Research Paper: The Notion of tax in Tax Treaties", *International Fiscal Association*, (December 2013), pp. 52-53.
[158] Ibid, pp. 52-53.
[159] Michael Lang, "Taxes Covered – What is a "Tax" according to Article 2 of the OECD Model?", *Tax Treaty Monitor*, (June 2005), pp. 222-223.
[160] Ibid, pp. 222-223.
[161] Ibid, pp. 222-223.
[162] Roland Ismer & Christoph Jescheck, "The substantive Scope of Tax Treaties in a Post-BEPS World: Article 2 OECD MC (Taxes Covered) and the Rise of New Taxes", *Intertax* 45, no. 5 (2017), pp. 386-387.
[163] Ibid, pp. 386-387.
[164] Ibid, pp. 386-387.
[165] Ibid, pp. 386-387.
[166] Cesare Silvani, IFA Research Paper: The Notion of tax in Tax Treaties", *International Fiscal Association*, (December 2013), pp. 52-53.

substantially similar tax imposed after the date of signature of the treaty shall be compared in line with the object and purpose of the treaty[167].

In the event the new tax is not similar to a listed tax, it could still be covered by the treaty in countries that do not omit the first two clauses of the Convention provided it is a tax on income. Tenore argues that newly introduced taxes should be read in conjunction with Articles 2(1) and 2(2)[168]. The Irish high court in the *Kinsella* case also stated that the ultimate responsibility for delimiting the scope of the treaty lies with the first two provisions[169]. Therefore, with respect to the EU windfall profits tax, it is more likely it will be covered by treaties that do not omit the first two clauses, as it might fail the comparability analysis with existing taxes listed in Article 2(3).

### 3.2 Relationship of Article 2 with Article 23

Article 23 (A & B) presents the two worldwide recognised methods, the exemption and the credit method, for the elimination of double taxation. Article 23 A expresses that "any resident of a Contracting State deriving income which may be taxed in the other Contracting State in accordance with the Convention", shall receive a full deduction of the amount equal to the tax paid by means of exempting that income from being taxed again[170]. Additionally, Article 23 B expresses that "a resident of a Contracting State deriving income which may be taxed in the other Contracting State in accordance with the Convention", shall receive a deduction from the tax to be paid in the resident country by means of calculating a credit equal to the amount paid in the source state[171]. Therefore, the principle of symmetry is embedded in the article as any tax levied in the source state will be relieved fully in the resident state and vice versa, regardless of the double taxation method chosen[172].

The relationship between Article 2 and Article 23 would be in theory straightforward, as any tax within the scope of the Convention where the income may be taxed in the other Contracting State, would be automatically entitled to receive relief of double taxation under Article 23. Article 2, therefore, establishes the limits of the application of double taxation relief. However, in practice, states in some instances, and mostly in the case of states adhering to the export neutrality principle and its associated credit method, provide double taxation relief subject to the provisions of their

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[167] Michael Lang, "Taxes Covered – What is a "Tax" according to Article 2 of the OECD Model?", *Tax Treaty Monitor*, (June 2005), pp. 222-223.
[168] Mario Tenore, "Taxes Covered: The OECD Model (2010) versus EU Directives", *Bulleting for International Taxation* 66, no. 6 (April 2012), pp. 4-5.
[169] Cesare Silvani, IFA Research Paper: The Notion of tax in Tax Treaties", *International Fiscal Association*, (December 2013), pp. 52-53.
[170] OECD, "Model Tax Convention on Income and on Capital: Condensed Version 2017", *OECD Publishing* (November 2017), p. M-60.
[171] Ibid, p. M-62.
[172] Cesare Silvani, IFA Research Paper: The Notion of tax in Tax Treaties", *International Fiscal Association*, (December 2013), pp. 25-27.

domestic law[173]. If an income tax is considered under national law to be an equivalent foreign corporation income tax, then it is creditable to receive relief. In other words, the notion of tax instead of being tied to Article 2, is defined for the purposes of methods of elimination of double taxation to domestic law[174]. As a result, sometimes relief is provided for taxes that are not included within the scope of Article 2, while qualifying taxes under the Convention are not credited[175]. Therefore, even in the event that any of the EU windfall profits taxes are covered by Article 2 of the OECD model, relief of double taxation might not be granted in countries following domestic law.

### 3.3 Double Taxation Analysis of the Spanish Solidarity Contribution

As seen above, the introduction of the solidarity contribution tax on energy corporations will most likely lead to double taxation. In the previous chapters, the thesis outlines the two main types of legal entities that are within the scope of the Spanish solidarity contribution, non-resident entities with at least 75% of their business volume derived in Spain from activities in the crude, petroleum, natural gas, coal and refinery sectors, and resident principal operators in the energy market. The OECD Model Tax Convention might not be entirely able to resolve double taxation for both non-residents and residents. For that reason, to answer sub-question three, which inquires to what extent is the Spanish Solidarity Contribution compatible with the OECD Model Convention, the Spanish contribution will be analysed by looking at how double taxation can be resolved for both groups separately.

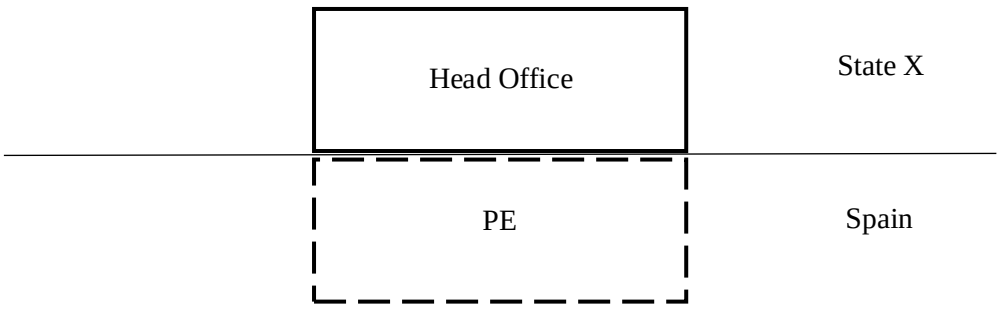
#### 3.3.1 Non-Resident Legal Entities in Spain

Non-resident legal entities with at least 75% of their business volume derived in Spain from the fossil fuel sector, could benefit from treaty protection in the case that the Spanish solidarity contribution leads to juridical double taxation. As depicted in the hypothetical scenario of Figure 1, a head office resident in a third state, State X, has a petroleum well in Spain which automatically triggers the establishment of a PE, and thus source taxation in Spain. Since the company's sole business volume derives from the fossil fuel sector, under national law, Spain can impose the solidarity contribution on the net sales attributable to the PE. On the other hand, the PE profits are part of the taxable profits of the head office, and as such State X is entitled to tax the resident head office on its worldwide profits. As a result, as the Spanish solidarity contribution is indirectly taxing business profits through a levy on net sales, the PE profits would be taxed twice in the hands of the

[173] Wei Cui, "Article 2 – Taxes Covered – Global Tax Treaty Commentaries", *IBFD* (August 2021), para. 6.2.3.
[174] Ibid, para. 6.2.3.
[175] Cesare Silvani, IFA Research Paper: The Notion of tax in Tax Treaties", *International Fiscal Association*, (December 2013), pp. 25-27.

same person by two different states. Therefore, the levy would create a situation of juridical double taxation as described by the OECD Model.

**Figure 1**




#### *3.3.1.1 Tax Treaty Applicability*

In this explanatory case, it is assumed that Spain has a tax treaty with State X that follows the latest version of 2017 of the OECD Model Tax Convention. For this example, since the head office is considered a resident entity under the domestic provisions of State X, the company can call upon the treaty protection between State X and Spain as stipulated in Article 1. The head office would, thus, be considered a person covered by the convention. The next step would be determining whether the Spanish solidarity contribution is within the scope of the treaty according to Article 2, to effectively be able to apply the treaty.

The Spanish solidarity contribution is deemed to be a tax under Article 2(1). It is imposed by a public body, the Spanish state, in the form of an additional tax with the aim to use it for the public interest. The contribution is an extraordinary tax in nature, but as seen in the previous sub-sections, the OECD model does not exclude extraordinary taxes from its scope. Thus, the first preliminary conclusion is that the contribution would be within the scope of the tax treaty between State X and Spain. However, the Spanish solidarity contribution might not be regarded as a tax on income since its taxable base is net sales. As discussed previously, there is not a harmonized definition of income in tax law, yet the Convention lays out clear examples of income items like dividends, interest or business profits. Income is, moreover, a flow figure that reflects the net accrual money value of the direct spending power of the taxpayer. While it is true that the Spanish solidarity contribution was enacted to tax the windfall profits of energy corporations, net sales reflect the gross money value generated per sold item of the corporations. Therefore, net sales are an indication of revenue and cannot be formally classified as income.

In the last years, turnover taxes imposed on revenues have had a resurge in the tax field, being a prominent one the DST imposed unilaterally by some countries like Hungary. Generally, a DST tax is imposed on the revenue businesses earn from specific digital transactions, capturing the turnover of entities operating in the digital services market[176]. Due to its design, deduction for expenses or being creditable against income tax rules is not allowed[177]. Moreover, DST liability is accrued even if the taxpayer reports losses[178]. Turnover levies are not characterized as indirect taxes, as they do not tax consumption, nor as direct taxes, as their taxable base is not profit or wealth. In the opinion of the *Vodafone* case, the Advocate General argues that the Hungarian DST intention was to tax the particular financial capacity of the undertakings by using turnover as a proxy for income since high profits are impossible without a corresponding high turnover[179]. The interim conclusion of the opinion, thus, expresses that the DST was a turnover-based income tax[180]. Therefore, DTS seems to be directed at taxing income that would otherwise escape from the tax base of the source state as it taxes revenues[181]. The turnover tax in some cases still seeks to tax income regardless of its design, ergo analysing if a levy taxes income should be based on a substance over form analysis.

The Spanish solidarity levy has, on the one hand, characteristics of a turnover tax as the levy is not deductible for expenses nor accreditable against the income tax rules. It is also imposed on net sales which is a direct indication of revenues businesses earn per transaction, and hence, it clearly captures the turnover of corporations operating in the energy sector. On the other hand, it could be argued that the levy is imposed on a measure of profit before the deduction of expenses, which indirectly captures the potential income of the taxpayer. As the Advocate General pointed out, without a high degree of net sales making a high net profit would be impossible. Furthermore, considering the intention behind the levy is to tax the extra financial capacity of corporations in the energy market profiting from the energy crisis, net sales could be seen as a proxy for income. Therefore, in accordance with a substance over form analysis, the Spanish levy is in essence a net-sales based income tax. In other words, the levy would be under the scope of the OECD Model, and a priori eligible to receive double taxation relief by the tax treaty between State X and Spain.

The applicability of the treaty to the situation depicted in Figure 1, would still hold if the treaty between State X and Spain contains all four clauses of Article 2 as stated in the OECD. Article 2(3) is meant to be illustrative and inform about the domestic law at the moment the treaty is signed,

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[176] Dario Stevanato, "Are Turnover-Based Taxes a Suitable Way to target Business Profits?", *European Taxation* 59, no. 11 (November 2019), pp. 538-540.
[177] Ibid, pp. 538-540.
[178] Ibid, pp. 538-540.
[179] Opinion of Mr. Advocate General Poiares Maduro, *Case C-58/08, Vodafine Ltd and Others v Secretary of State for Business, Enterprise and regulatory Reform*, ECLI:EU:C:2009:596, [2009], para. 31-37.
[180] Ibid, para. 103.
[181] 12. Adolfo Martin Jimenez, "Controversial Issues About the Concept of Tax in Income and Capital Tax Treaties in the Post-BEPS World", in *Tax Treaties After the BEPS Projects: A tribute to Jacques Sasseville*, ed. Brian J. Arnold (Toronto: Canadian Tax Foundation, 2018), p. 178.

meaning given that the Spanish levy was implemented when the treaty was in force and is not in the list does not mean it is automatically excluded from the scope. The first two clauses have the ultimate responsibility when defining the scope of the treaty, and as long as a tax not mentioned in Article 2(3) is considered a tax on income under the first two clauses it is within scope.

In the event that the treaty between State X and Spain does omit the first two clauses of Article 2, it could be that the Spanish solidarity contribution encounters problems to secure treaty coverage. Spain does not traditionally omit the two first clauses of the article in its treaties, but some treaties with Anglo-Saxon countries, for instance the US and Australia, do not contain the provisions. Spain normally only lists two taxes in Article 2(3), the PIT and the CIT as established by domestic law. The solidarity contribution could be compared to the Spanish CIT to identify whether they are substantially similar, and thus the former could still be covered by the treaty under Article 2(4). Firstly, the subject of the tax is both legal entities, yet the solidarity contribution only targets legal entities in the energy sector. Secondly, despite that the solidarity contribution aims to tax windfall profits the object of taxation is net sales, while for CIT purposes the object is net profits. Therefore, the calculation of the tax base also differs significantly. Thirdly, the purpose of both taxes is to tax the financial capacity of undertakings. Taking into consideration that most of the countries do a comparability analysis focused on the taxable base, most likely than not the Spanish solidarity contribution would not be deemed similar to pre-existing taxes. Nevertheless, new taxes need to be compared in line with the object and purpose of the treaty. Given this thesis argues they are in substance a tax on income, they could still be deemed similar enough to be covered by the treaty.

After analysing the treaty applicability, the conclusion is that the Spanish solidarity contribution, following a substance over form approach, is within the scope of the OECD Model and thus the treaty between State X and Spain would be applicable in the hypothetical scenario depicted in Figure 1. This claim would hold mostly if the treaty does contains all the clauses of Article 2.

It could be possible that State X does not consider the Spanish solidarity contribution as a tax on income nor a substantially similar tax to those listed in Article 2(3), and would thus not apply treaty protection in the scenario depicted in Figure 1. The head office, regardless of any remedies domestic law may provide, can request the assistance of a competent authority under the MAP procedure laid out in Article 25 of the OECD Model. The article states that "where a person considers that the actions of one of both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, […] present his case to the competent authority of either Contracting State"[182]. Accordingly, uncertainty on whether the Convention covers a

[182] OECD, "Model Tax Convention on Income and on Capital: Condensed Version 2017", *OECD Publishing* (November 2017), p. M-68.

specific tax or income item, can be resolved under Article 25 by encouraging both competent authorities to consult and decide the applicability of the treaty on the Spanish levy[183].

#### *3.3.1.2 Double Taxation Relief*

The OECD Model Convention lays out in several articles the rules to allocate the taxing rights between the countries depending on the different types of income items. In this case, the income being taxed by the Spanish solidarity contribution is business profits. Article 7 indicates that "profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. […] the profits that are attributable to the permanent establishment in accordance with the provisions of paragraph 2 may be taxed in that other State"[184]. The definition of PE under the OECD Model in Article 5, similar to Spanish law, considers a petroleum well a PE[185]. Therefore, under Article 7, in the hypothetical scenario of Figure 1, Spain would have exclusive taxation rights on the business profits of the PE derived within Spain, and State X would not be entitled to tax.

Given the allocation of taxing rights, State X under Article 23 would need to grant the head office a deduction from the tax to be paid on their profits, equal to the amount of the Spanish tax, in either the form of an exemption or credit. Even though Article 23 lays down the conditions for eliminating double taxation, if State X provides relief subject to domestic law, the head office might not be granted a deduction. This situation would most likely happen if State X used the credit method for the elimination of double taxation. For instance, in the US, for a foreign tax to be creditable it needs to be a tax on income imposed by a foreign taxing authority as ruled by the I.R.C. §901[186], which needs to satisfy the three gain test requirements, i.e. realization, gross receipts, net income[187]. The Spanish solidarity contribution could fail to pass the net income test as it is not imposed on the difference between revenues and expenses. In the end, being creditable would depend on whether the analysis follows a substance analysis of the design and considers the purpose of the foreign law or takes a formalistic approach. Notwithstanding, the OECD Model does allocate taxing rights to Spain and obliges State X to grant a deduction, and thus, as long as State X follows the principle of symmetry and the Convention, double taxation would be eliminated.

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[183]TPA, "Manual on Effective Mutual Agreement Procedures (MEMAP)", *OECD*, (February 2007), p. 8.
[184] OECD, "Model Tax Convention on Income and on Capital: Condensed Version 2017", *OECD Publishing* (November 2017), p. M-27.
[185] Ibid, p. M-19.
[186] Kenneth J. Vacovec et. al, "The U.S. Foreign Tax Credit for Corporate Taxpayers", *International Bureau of Fiscal Documentation*, (September 2001), pp. 400-401.
[187] Viva Hammer, "United States – US Update", *Bulletin for International Taxation* 66, no. 12 (November 2012), p. 646.

### 3.3.2 Resident Legal Entities in Spain

As seen already in Chapter 5.2, the chances that a non-resident legal entity will be affected by the Spanish solidarity contribution are extremely low as the concept of residency is broad and Spain's fossil fuel sector is dominated by resident legal entities. Therefore, the situation depicted in Figure 1 will be unlikely, as the main corporations that will be affected by the Spanish solidarity contribution are principal operators.

All the principal operators within the scope of the levy, as already seen, are residents for tax purposes in Spain. Despite their residency status, being a Spanish entity does not mean that these entities could be part of a foreign-controlled corporate group. Using the database Orbis, which is a private database containing information on companies worldwide about their corporate ownership structures, the corporate group structures of the principal operators within the scope of the Spanish solidarity contribution have been identified in Table 3.

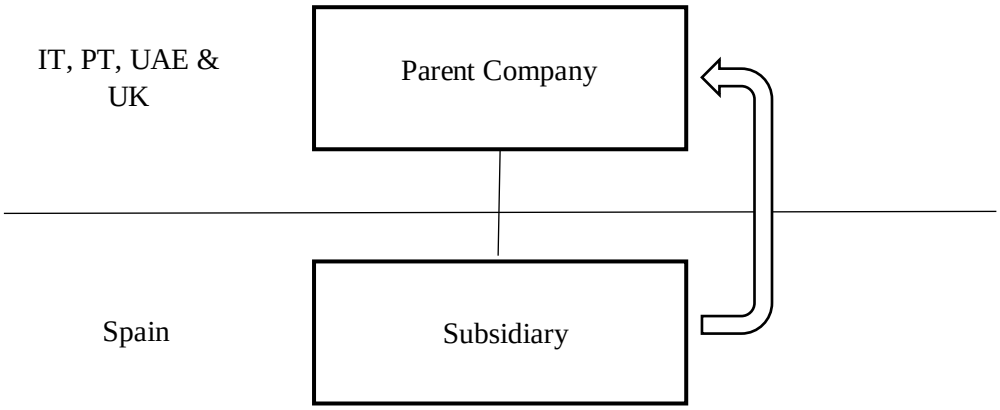
**Table 3**

| *Principal Operator* | *Type of Entity* | *Global Ultimate Owner Entity* | *Country of Parent Company* | *Percentage of Ownership* |
|---|---|---|---|---|
| Endesa, SA | Subsidiary | Enel SPA | Italy | 70.10% |
| Iberdrola, SA | Parent Company | n.a. | Spain | n.a. |
| Naturgy Energy Group, SA | Parent Company | n.a. | Spain | n.a. |
| EDP Energías, SA | Subsidiary | Energías De Portugal S.A. | Portugal | 100% |
| Repsol, SA | Parent Company | n.a. | Spain | n.a. |
| CEPSA, SA | Subsidiary | Mubadala Investment Company P.J.S.C. | United Arab Emirates | 61.36% |
| BP España, SA | Subsidiary | BP PLC | United Kingdom | 100% |
| Petronieves, SL | Parent Company | n.a. | Spain | n.a. |

Of all the principal operators affected by the Spanish levy, four of them are subsidiaries of a corporate group with the ultimate parent company resident in another country. The countries of

residency of the parent companies are Italy, Portugal, United Arab Emirates, and the United Kingdom. As shown in Figure 2, if the subsidiaries distribute the profits in the form of dividends to the parent company, the four countries would consider the dividends part of the parent company taxable profits. As a result, the profits of the subsidiaries would be taxed firstly by the Spanish solidarity contribution in the form of net-sales income tax, and then a second time by CIT in the parent company country, ultimately causing double taxation. However, in this case, the business profits are not taxed twice in the hands of the same person, but rather the business profits are taxed twice in the hands of different persons as the subsidiaries are a different legal entity than the parent company. Therefore, the situation depicted in Figure 2 represents the case of economic double taxation, which is defined by the OECD as more than one person being taxed on the same income item[188], and not juridical double taxation.

**Figure 2**




Since the OECD Model Convention only covers juridical double taxation, the scenario depicted in Figure 2 would not be solved under tax treaties. The double taxation caused by the Spanish solidarity contribution can only be tackled at the level of the parent company if the four countries identified have domestic provisions that allow a deduction for repatriated foreign profits. Commonly these domestic systems, known as participation exemption regimes, prevent double taxation of dividends and capital gains deriving from foreign subsidiaries by providing an exemption from CIT[189]. Although not all countries offer a full exemption, most do offer either a partial

[188] OECD, "Glossary of Tax Terms", *OECD Home*, Accessed May 14, 2023, https://www.oecd.org/ctp/glossaryoftaxterms.htm#E
[189] Paul J.M. Bruin & Diederik G.A. Meijer, "Currency Exchange Results and the Participation Exemption", *International Bureau of Fiscal Documentation* (May 2003), p. 90.

exemption or a credit under specific conditions[190]. In practice, the exemption means that the parent company does not count the subsidiary profit as taxable profit, meaning the same profit is only taxed once at the subsidiary level[191]. Therefore, even though the OECD Model does not provide a solution, the double taxation caused by the Spanish levy can be solved by participation exemption regimes.

In the EU the Parent Subsidiary Directive was approved in 2011, which aims at exempting dividends and other profit distributions paid by subsidiaries to their parent company across the EU[192]. The idea behind the directive is to facilitate the grouping of companies within the EU and effectively ensure the functioning of the internal market[193]. The directive applies to companies of a MS receiving distributions from another company in another MS, and thus it does not apply to third countries[194]. A company of a MS is defined in Article 2 as taking the form of a constituted corporation according to domestic law that is a taxable resident of the MS and subject to CIT without exemptions[195]. Under this definition, both Endesa and EDP Energías are within the scope of the directive. To qualify as a parent company, the holding entity must hold a minimum of 10% in the capital of the company of another MS fulfilling the conditions[196]. Since both Enel and Energías de Portugal hold more than 50% of shares in the Spanish principal operators, they qualify as a parent company for the purposes of the directive. Therefore, according to Article 4 the MS of the parent company, Italy and Portugal, need to either refrain from taxing the subsidiaries profits or allow a deduction from the amount of corporate tax[197], in this case the Spanish solidarity levy, related to the subsidiary's profits.

In Italy, under Article 89 of the income tax framework, a 95% participation exemption is applicable to dividend distributions from other MS subsidiaries to parent companies resident in Italy fulfilling the conditions laid out in the Parent Subsidiary Directive[198]. This means that the remaining 5% is subject to CIT in Italy. In contrast, Portugal under Article 51 of the income tax legislation applies a full exemption to companies fulfilling the conditions of the directive, provided the holding company has owned the shares for an uninterrupted period of at least 12 months prior to the distribution[199]. Given that the holding company of EDP Energías has owned the entity for longer than one year, the parent company can receive the full exemption in Portugal. As a result, both principal

[190] Ibid, p. 90.
[191] Ibid, p. 90.
[192] Council Directive 2011/96/EU, of 30 November 2011, on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, *Official Journal* L 345/8, (November 2011), p. 8.
[193] Ibid, Preamble, p. 8.
[194] Ibid, Article 1, p. 8.
[195] Ibid, Article 2, p. 9.
[196] Ibid, Article 3, p. 9.
[197] Ibid, Article 4, p. 10.
[198] Carla Calcagnile & Luca Ferrari, "Italy – Holding Companies – Country Tax Guides", *IBFD* (March 2023), para. 3.2.3.2.
[199] Maria Quintela & Joao Miguel Fernandes, "Portugal – Holding Companies – Country Tax Guides", *IBFD* March 2023), para. 3.2.3.2.

operators Endesa and EDP Energias, their parent companies will receive a double taxation relief for the Spanish solidarity contribution.

However, two countries, the UK and the UAE, of the parent company for CEPSA and BP España are located outside the EU, which means that the parent subsidiary directive does not apply to them. In the UK part 9A of the corporate tax act 2009 provides an exemption for most dividends received by resident companies under certain conditions[200]. The exemption applies to cash dividends received from controlled companies, controlled being defined as holding at least 40% of interests, rights and powers of the payer[201]. In this case since BP Plc owns a 100% of the shares in BP España, they would qualify for the exemption. The relief is limited to several anti-avoidance provisions and types of payments associated with abuse yet given that BP España is conducting real business and the structure of the group is not to avoid taxes, the profit distribution is considered entitled to receive the exemption. Finally, the UAE does not have a CIT implemented for all legal entities, it only applies currently to upstream petroleum activities[202]. The parent company of CEPSA is an investment financial company and as such it is not subject to CIT in the UAE. In other words, since the distributed profits are not subject to CIT there is no need to have or grant a participation exemption. Therefore, even outside of the EU economic double taxation caused by the Spanish solidarity contribution is prevented.

To conclude, the analysis from Chapter 3 illustrates that the Spanish solidarity contribution is covered by the OECD model and thus it is automatically entitled to receive relief for juridical double taxation. Despite the unlikeliness non-residents will be affected by the levy, even in the cases of economic double taxation relief is provided by participation exemptions regimes. As a result, in most cases the Spanish solidarity tax does not lead to unsolvable double taxation. Therefore, the answer to sub-question three, which explores the compatibility of the Spanish levy with the OECD model, is that the solidarity contribution following a substance over form analysis is compatible with the model. Overall, no issues of legality exist between the Spanish solidarity contribution and International law on Double Tax Conventions.

## Chapter 4: Conclusion

The energy crisis, mainly caused by the war in Ukraine, lead to disruption in the EU economy leaving families struggling to meet ends, while energy corporations primarily in the fossil fuel sector were reporting record net profits never seen before. Taxation, which can be a powerful redistributive tool, was envisioned by the Commission and policymakers alike as one of the solutions to tackle the

[200] Matthew Herrington, "United Kindgom Italy – Holding Companies – Country Tax Guides", *IBFD* (April 2021), para. 4.1.2.
[201] Ibid, para. 4.1.2.
[202] Adheela Abdul Raheem, "United Arab Emirates – Corporate Taxation – Country Tax Guides", *IBFD* (January 2023), para. 1.1.

windfall profits energy corporations were enjoying. As a result, the first ever EU-wide windfall profits tax imposed on energy corporations was temporarily established by an emergency regulation passed under Article 122 TFEU until at least December 2023. Despite the binding nature and direct applicability of the regulation for MS, the new legislation is a rule of minimis that allows MS to go beyond the necessary as long as there is a minimum standard of comparability ensured. Therefore, MS could derogate and create windfall profits taxes that had the same objectives and generated similar proceeds. Spain, for instance, formally implemented the windfall profits tax, called solidarity contribution, in November 2022.

Research literature on previously enacted windfall profits taxes had shown that these extraordinary levies are not necessarily an appropriate policy tool. Economists had focused on studying whether the levy is efficient and neutral, while legal scholars had centred on the justifications to tax windfalls. Research had thus not explored if windfall profits taxes can have compatibility issues with fiscal law, mainly due to a lack of real-life examples. For that reason, the aim of the thesis was to uncover any potential legality issues the implementation of the EU wide windfall profits tax could lead to. Since MS had the choice to deviate from the regulation and studying the EU tax was extremely wide in scope, the thesis analysed the case study of Spain. Spain, moreover, was academically interesting as they enacted a levy that is extremely different in scope, tax base and tax rate compared to the EU levy. Therefore, the main research question of the thesis was; *What are the potential issues of legality of the new Spanish solidarity contribution on energy corporations?*

To answer the research question, using a traditional legal methodology, the thesis scope focused on two levels of taxation law, European and International. Therefore, the thesis was divided into three sub-research questions that investigated the compatibility of the Spanish solidarity contribution with first the EU emergency regulation on energy prices, secondly with the fundamental freedoms, and, thirdly with the OECD Model Tax Convention. The main conclusion of the thesis is that the Spanish solidarity contribution does not lead to any potential issue of legality either at a European or International level.

The analysis conducted showed that given that the regulation is a rule of minimis, the Spanish solidarity contribution is more burdensome, meaning it is compatible with the EU regulation and no legality issues exist with EU secondary law. Furthermore, the Spanish solidarity contribution does not treat non-residents compared to residents less favourably as they are both subject to tax in the same manner, meaning there is no discrimination that could have led to an infringement of the fundamental freedoms. In addition, the thesis explored the existence of reverse discrimination, yet the levy does not cause reverse discrimination nor is reverse discrimination under the scope of the fundamental freedoms as stipulated by the CJEU. Therefore, the Spanish solidarity contribution is also compatible

with the fundamental freedoms and no issues of legality exist with EU primary law. The analysis also showed that based on a substance over form analysis the Spanish solidarity contribution is a net sales income tax covered by Article 2 OECD Model Convention. The tax is thus entitled to receive double taxation relief under tax treaties and should only encounter problems if the Contracting States apply domestic law. The analysis, furthermore, showed that even for resident entities that are not within the scope of the model, double taxation was solved by participation exemption regimes. Therefore, the Spanish solidarity contribution does not lead to legality issues with the Double Tax Conventions.

The conclusion of the thesis has some limitations as it could be challenged by scholars or tax jurisdictions that follow a formalistic analysis approach. They could argue, for instance, that the Spanish solidarity contribution is not equivalent to the EU regulation or given that it is a revenue tax, it is not covered by tax treaties. Nevertheless, the latest developments in academia and the tax field have moved towards using a substance over form analysis methodology, and for that reason, the conclusion of the thesis is robust. Future research should focus on exploring the potential legality issues of the Spanish solidarity contribution or any other EU windfall profits tax in relation to domestic tax law. It is plausible that this levy could infringe the ability to pay or the principle of equality enshrined in national constitutions. Furthermore, it would be interesting to analyse how effective the implementation of the EU regulation has been in combating the energy crisis. Similarly, future research could also conduct a comparability analysis between different implementations of the EU windfall profits tax by MS from both an economic and legal perspective. Overall, despite their potential, windfall profits taxes are widely unresearched, but the EU wide windfall profits tax has provided a unique opportunity to study these taxes in a real-life setting, an opportunity that should not be wasted.

To conclude, the results have contributed to the academic debate by showing that windfall profits taxes are indeed a legal instrument with no compatibility issues that can be part of the policy toolkit available in times of crisis caused by extraordinary events. Europe faces an increasingly challenging geopolitical context, as the war in Ukraine is still going on, and MS are already experiencing the effects of climate change. Windfall profits taxes, thus, can be effective in redistributing wealth, ultimately helping to create a stronger Union. My recommendation to MS and the EU is that windfall profits taxes should be considered as a complementary tool to respond quickly to crises as they are compatible with the European and International tax legal systems, but they should be used with caution taking into consideration their proven disadvantages.

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