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Polycrisis, Megatrends – Tax Policy Trends and Responses

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Abstract: The EU relies heavily on labor taxation including social security contributions (accounting for more than half of all EU-27 tax revenues), though it can discourage labor market participation. Besides, ageing, digitalization, global markets, new forms of work and increasing labor mobility question the residence-based principle of personal income tax. The sustainability of the social security system can be promoted by additional behavioral tax (linked, for example, to the consumption of unhealthy products or the use of risky services). In the former socialist countries analyzed in this study (Croatia, Bulgaria, Latvia, Estonia, Hungary, Poland and Romania), the share of consumption taxes in total tax revenue is above 38%, well above the EU average. In countries with high consumption tax rates and significant consumption tax revenues, both labor and capital income tax revenues are typically below the EU average. The share of environmental taxes in tax systems is low, both on average in the EU and in the examined countries (although most of them are at or above average). Nonetheless, in the former socialist countries, the share of property taxes is lower than the EU average (for historical reasons, property taxation is less accepted by their societies). According to a Commission study published in 2024 (see: "Growth-Friendly Taxation in a High-Inflation Environment," European Commission, European Economy Economic Brief 079), strengthening property taxation would help to make the tax system fairer, although not in a time of high inflation and crisis. Harnessing the potential of digitalization contributes to efficient and effective tax

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administration and can also reduce administrative costs, thus facilitating compliance. Latvia, Hungary and Poland recorded an exceptionally large improvement in VAT compliance, with VAT gaps falling between 2013 and 2021 by over 15 pp, which turned them into the best performers in the EU (Romania still faces challenges in the field of tax avoidance, VAT compliance gap and inefficient tax auditing). Tax administrations in most of the analyzed countries are therefore well adapted to the challenges of digitalization. The future tax system must implement a desirable green tax reform shifting a part of the tax burden away from labor to tax bases linked to environment taxes and other behavioral taxes – regarding the sustainability of the tax system as the European and national budgets face significant financial pressure due to the polycrisis, megatrends and EU loans.

1. Introduction

We live in the age of polycrisis: European economies experience multiple crises affecting them simultaneously. Historically high inflation last year and the energy crisis are just the tip of the iceberg. What type of challenges have to be faced? What global or region-specific crises does Europe have to face? Besides urgent emergencies, European economies also have to face other challenges, referred to as megatrends,[1] that have long-term structural impacts on economies and societies. And what types of solutions can the tax policy offer to tackle crises and megatrends? This study systematizes these challenges and the tax policy measures that seek to respond to them at the EU governmental level and in certain Member States (especially in Hungary, Poland, Estonia, Latvia, Romania, Bulgaria and Croatia). In the presented analysis, in addition to synthesizing the legislation and the literature examined, statistical data will be processed and compared. The source of international comparative data is the European Commission documents. As the Commission's publications on taxation for 2023 were available at

[1] European Commission, "Annual Report on Taxation 2023. Review of Taxation Policies in EU Member States," Publications Office of the European Union, Luxembourg 2023. Hereinafter: European Commission, 2023.

the time of writing[2] and they cover either 2020 or 2021, the study essentially covers trends in the period 2008–2020/2021.

2. Polycrisis, Megatrends

In the last decade and a half, there have been several economic crises. After European economies managed to recover from the crisis of 2008/2009, the COVID-19 virus caused a global pandemic that stalled the economic prosperity from 2020 and disrupted consumption, production and global value chains. Amid the recession due to the COVID-19 epidemic, the negative impacts of the energy crisis caused by the Russian-Ukrainian war, the sanctions introduced against Russia and Russia's limitation of supplies have spilled over pushing up energy prices and inflation to levels not seen in decades. Exceptional economic circumstances required extraordinary government interventions at both national and EU governmental levels – putting public finances under significant pressure.

The demographic changes in Europe – as a long-term challenge – involve a pressing issue, the migration crisis. Since 2015, migration has been an ongoing and growing burden on Member States' social systems and budgets.[3] At the EU level, the present multiannual financial framework (from 2021 to 2027)[4] provides increased commitment appropriations in a new chapter (4. Migration and Border Management) to cover some of the costs of migration, but there are debates among Member States on border protection and the so-called migration quota. The large number of refugees from Ukraine further deepens social and economic tensions resulting from migration.

Meanwhile, in terms of impact, the most serious emergency is the climate crisis which needs to be tackled much more effectively than it is at present. The possibility of preventing and remedying the environmental

2 Completion date of the study April 30, 2024.

3 Csaba Lentner, *East of Europe, West of Asia. Historical Development of Hungarian Public Finances from the Age of Dualism to the Present* (L'Harmattan, Paris 2020), 303.

4 Council Regulation (EU, Euratom) 2020/2093 of 17 December 2020 laying down the multiannual financial framework for the years 2021 to 2027 (O.J.E.C. L433I, 22 December 2020), 11–22.

damage caused by the climate crisis is increasingly being questioned because governmental and social measures are insufficient.[5]

These crises – primarily the environmental crisis – may threaten not only the quality of life but also the living conditions in European countries and therefore require immediate solutions.

Besides urgent emergencies, European economies also have to face the challenge of megatrends[6] that have long-term structural impacts on economies and societies. These megatrends are noticeable and global, and will also influence government interventions in the future, including tax policy measures.

What megatrends do European societies have to face? According to the European Commission, they are technological advancement (especially digitalization), globalization and changes in global trade (for example, supply-chain shifts, offshoring versus onshoring), ageing population, labor market shifts, increased inequalities, climate change and environmental degradation. Unlike the Commission, the urgency of tackling climate change already requires emergency solutions, so goes beyond the megatrend category and is a crisis that needs to be addressed immediately. However – even if not mentioned by the Commission – it is worth mentioning the growing and high level of public debt of European countries as a megatrend. These megatrends are briefly identified below.

Looking at a broader time horizon, socio-economic changes, such as unsustainable population growth, increasing social inequalities and migration are global processes that require actions. The demographic challenges in Europe involve a more pressing issue – migration – and sometimes are different to global trends, as Europe has an ageing population[7] similar to other developed economies. Social problems have a long-term impact on the structure of the economy and the tax system. The ageing of European societies results in a decline in working age population alongside increased age-related public expenditure and increased automation of tasks.

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[5] The climate risks are so important that the central banks gain specific tasks to maintain sustainability. See: János Kálmán, Gábor Hulkó, and András Lapsánszky, "Sustainability Objectives and Central Banks," *Chemical Engineering Transactions* 107, no. (2023): 331–6.

[6] European Commission, 2023.

[7] According to the European Commission (2023), 31, the EU's population is ageing and projected to start declining by 2030.

The longer life expectancies and lower fertility rates, the development of medicine and the increase in the average age put the health care and pension systems' sustainability, and the European welfare states at risk.

Increasing inequality is a global concern. Globalization and technological advancement have a double impact on this phenomenon. While they have contributed to progress and increased overall wealth, they have also led to the growing gap between richer and poorer individuals. Furthermore, the COVID-19 pandemic has aggravated many existing disparities. Inequalities in the EU are generally lower than in the rest of the world and indicators have improved in many areas over the past two decades. However, income inequality dynamics vary widely across regions and social groups (e.g. poverty among children and single-parent households), and the EU average hides an increase in Southern Europe, especially during the financial and sovereign debt crises.[8] Redistributive tax policy measures should therefore continue to complement social benefits to reduce disparities.

As far as technological advancement is concerned, digitalization and globalization are two megatrends that complement and intensify each other. These phenomena reshape labor markets. The automation of work processes and the development of artificial intelligence could lead to the disappearance of certain professions or their replacement by machines. However, digitalization can also help to increase employment by creating new forms of work (such as teleworking and platform work) and increasing labor mobility. The positive labor market effects of digitalization (such as remote working, platform work and increasing labor mobility) not only provide the maintenance of the income tax base but also bring new tax policy challenges (questioning the residence-based principle of personal income tax). Globalization[9] also expands the markets and increases workers' access to international labor markets.

Due to globalization, expanding markets prompt higher levels of labor and capital mobility (even capital remains more mobile)[10] and also facilitate aggressive tax planning (ATP) for multinational companies and tax competition of states (resulting in overall reduced tax rates and tax revenues).

8 European Commission, 2023: 33.
9 European Commission, 2023: 16.
10 European Commission, 2023: 32.

These processes led the OECD to make global efforts on base erosion and profit shifting (BEPS), resulting in the two-pillar approach of the Inclusive Framework.[11]

Digitalization generated new developments: big data and crypto assets. On the one hand, big data offers opportunities to improve the efficiency and effectiveness of tax procedures and the exchange of information between tax authorities. On the other hand, the increasing relevance of crypto assets calls into question the taxation of such assets and their derived income.[12]

3. Tax Policy Trends in the EU and Certain Member States

Not only do the crises and the megatrends affect tax policy measures, but they are also influenced by the government's approach to the role of the state and state interventions, and even more by the specialties and limitations of the current tax system. This chapter focuses on EU trends (EU average) examining the taxation practices of Member States (MSs), with particular regard to certain former socialist countries (such as Hungary, Poland,[13] Estonia, Latvia, Romania, Bulgaria and Croatia).

In 2021, the average tax burden was 40.1% of the GDP in EU Member States, which was higher than the OECD average of 34%, and that of Japan (33%) and the US (27%).[14] This could lead to the conclusion that European societies are very comprehensive welfare states which require funding. Even if the average value hides significant differences between EU Member States, the largest tax-to-GDP ratios were in Denmark (48.1%) and France (45.1%), and the lowest ratios were in Ireland (21.1%) and Romania

11 Éva Erdős, "Current Challenge in Fighting Against Tax Avoidance in the European Union: Link Between Sustainability and Taxation," *Curentul Juridic* 25, no. 4 (2022): 109–21.

12 Zsolt Halász, "Regulating the Unregulateable," *Hungarian Yearbook of International and European Law* 10 (2022): 217–30; Zsolt Halász, "Állami pénzkibocsátás vs virtuális fizetőeszközök," in *Magistra et Fautrix: Halustyik Anna emlékére*, ed. Zsolt Halász (Pázmány Press, 2019), 167–82; Zsolt Halász, "Legal Risks and Challenges Related to Virtual Currencies," in *Fostering Innovation and Competitiveness with FinTech, RegTech, SupTech*, eds. Iustina Alina Boitan and Kamilla Marchewka-Bartkowiak (IGI Global: Hershey (PA), 2021), 142–60.

13 Due to the COVID-19 and energy crisis, the examination of the Polish date and tax measures was carried out in 2023 with the support of the International Visegrad Fund (62310052). This study is published as a direct outcome of the project.

14 European Commission, 2023: 23.

(26.5%).[15] This shows that the role of the government is below the EU average in the countries surveyed and particularly low in Romania (by EU standards; see Table 1).

Table 1. Tax revenue as % of GDP (2020)

Taxes	Croatia	Hungary	Poland	Estonia	Latvia	Bulgaria	Romania	EU-27 average
consumption	18.2	14.1	12.4	13.3	13.4	14.1	10.0	10.8
VAT	12.1	9.8	8.0	9.1	8.6	9.2	6.1	6.9
labor	14.1	16.3	14.4	18.1	15.7	11.5	13.0	21.5
PITs	3.6	5.3	5.3	6.2	6.1	3.5	2.4	9.9
capital	4.7	5.9	8.9	2.7	2.5	5.0	3.3	7.9
CITs	2.3	1.2	2.3	1.7	0.7	2.2	1.9	2.4
environmental	3.3	2.2	2.5	2.4	3.1	3.0	1.9	2.2
property	1.1	1.1	1.7	0.3	1.0	0.7	0.6	2.3
total	37.0	36.3	35.7	34.0	31.5	30.6	26.3	40.2

Source: own compilation (based on European Commission, 2022).

Shifting the focus of the research to tax revenues by tax base regarding EU average, the tax structure is characterized by labor taxes including social security contributions from employers and employees (around 20% of GDP) being almost twice as high as consumption tax revenues (10–12% of GDP). This is complemented by capital taxation (approx. 8% of GDP). In the last one and a half decades, there has been an increase in labor tax revenues to 21.5% of GDP (in 2020) and less reduction in capital and consumption taxes. On this basis, the taxation of income and capital is generally dominant (almost 30% of the GDP) in the EU Member States, regarding the average tax burden (40.1% of GDP) in 2020.[16]

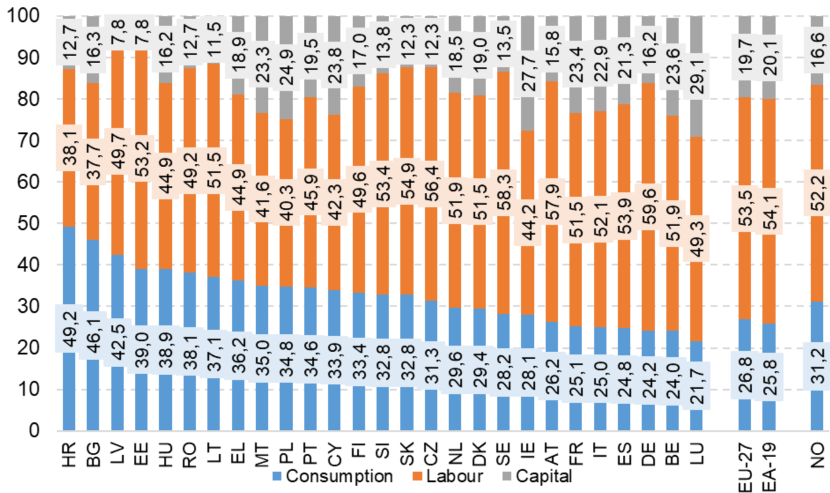
If the distribution of tax revenues by tax base is examined, the difference is much more striking and the details vary in some Member States. Between 2008 and 2021, labor tax revenues (including social security contributions) accounted for 52% of total tax revenues, tax revenues on capital

15 Ibid.

16 European Commission, 2023: 24–5.

income for 20% and consumption tax revenues for 28% of total tax revenues in general on average in the EU-27.[17] Therefore, the EU-27 in general relies heavily on labor taxation. However, the structure of taxation differs markedly among Member States.

Figure 1 shows the distribution of tax revenue according to the type of tax base regarding total taxes in 2020.[18]



* NO = Norway

Figure 1. Distribution of tax revenue according to the type of tax base, 2020 (% of total taxes; European Commission, 2022).

The share of labor taxes (including PIT and social security contributions) in total tax revenue is above 56% in Germany, Sweden, Austria and the Czech Republic, well above the EU average of 53.5% (see Figure 1). These countries are typical examples of welfare state policies. Top statutory personal income tax rates decreased from 44.8% (2000) to 38.9% (2022) in

[17] "Taxation Trends in the European Union. Data for the EU Member States, Iceland and Norway," European Commission (EU), Luxembourg, 2022, 32. Hereinafter: European Commission, 2022; European Commission, 2023: 26.

[18] The figures for 2021 are almost identical to those for 2020. See: European Commission, 2023: 27.

the EU. The top PIT rate varies substantially in the EU, ranging from 10% in Bulgaria to over 55% in Denmark.[19] In Bulgaria and Croatia, the tax burden on labor within the tax system is extremely low (under 40%).

The indicator measuring the effective tax burden on labor is the implicit tax rate (ITR) on labor. The ITR on labor contains the overall tax burden on all employed labor (it is calculated by dividing taxes and social contributions on employed labor income by the total compensation of employees and payroll taxes). The ITR is used for examining the share of different taxes and duties within labor taxation.

Figure 2. Composition of the implicit tax rate on labor, 2020 (%; European Commission, 2022, 44).

In most Member States, social security contributions of employees and employers account for a much greater share of labor taxes (two-thirds of the ITR on average) than PIT. According to Figure 2, the ITR on labor was 38.1% in 2020 in the EU-27, a stable figure since 2013. Even though the level of the ITR on labor varied across Member States. The highest ITRs were in Italy (44.1%), Belgium (40.9%) and Austria (40.8%), and the lowest in Malta (23.6%), Bulgaria (25.4%) and Croatia (28.1%) in 2020. In Denmark,

[19] European Commission, 2022: 38–9.

the tax burden on labor shows a unique picture, as social contributions are very low, so general taxation largely finances welfare spending. In Romania, on the other hand, PIT is only 13% of the ITR on labor, with 79% of the contribution made by employee social contributions (similarly to Lithuania).[20]

Table 2. Distribution of the ITR on labor (2020, %)

Member State of the EU	PIT	Employees' SSC	Employers' SSC and payroll taxes	ITR
Croatia (HR)	5.5	11.4	11.2	28.1
Hungary (HU)	10.4	13.6	14.1	38.2
Poland (PL)	6.0	14.3	13.7	33.9
Estonia (EE)	9.6	1.0	21.4	32.1
Latvia (LV)	10.3	5.7	13.6	29.6
Bulgaria (BG)	6.3	6.8	12.3	25.4
Romania (RO)	4.2	24.6	2.3	31.1
EU-27	12.7	8.5	16.8	38.1

Source: own compilation (based on European Commission, 2022, 44).

All of the countries surveyed have a lower tax burden on personal income than the EU average with the value of ITR below the EU average (in Hungary it is in line with the EU average). The ITR is exceptionally low in Bulgaria and Croatia. Romania and Estonia show an interesting disparity. In Romania, social security contributions paid by employees dominate labor taxes, while in Estonia it is social and payroll taxes paid by the employer that dominate.

The share of tax revenue on capital income (mainly income of corporations, besides income of households and self-employed) is very high in Luxembourg and Ireland, but also significant in Poland, so capital taxes are the dominant fiscal revenue in these countries (see Figure 1). Not always is there a correlation between tax rates and tax revenue share. Regarding top

20 European Commission, 2022: 42–3.

statutory corporate income tax rates, the lowest rate is in Bulgaria (10%) and Hungary (10.8%),[21] in terms of CIT revenue as a share of GDP, Bulgaria is 16th in the EU ranking, while Hungary is 26th.

In the last 10 years, the overall implicit tax rate (ITR) on capital increased in most Member States (excluding Cyprus, Hungary, Luxembourg, Slovenia, Denmark, Ireland, and Romania) and following similar trends, the ITR on capital income increased in most countries (except Cyprus, Luxembourg, Greece, Hungary, Romania, Finland and Slovenia).[22] A significant decrease was observed in Hungary[23] and Cyprus.[24] In 2020, the ITR on capital was almost 60% in France, while in Belgium and Denmark, its values were close to 40%. These three countries are also among those with the highest revenue from property taxes.[25]

Capital tax rates (see Table 2) and capital tax revenues of GDP (see Table 1) are at a lower rate than the EU average in the countries surveyed, though Hungary[26] and Bulgaria apply a super-low tax rate to encourage tax competition in the Central-Eastern-European region.

Where the tax rate is high, there is progressive taxation, and different tax policy measures are used to alleviate the tax burden on businesses: typically, a lower tax rate is applied up to a relatively high threshold of profits or the tax base is determined in a specific way. For example, in Poland, from 2020, the corporate tax rate is 9% up to €2 million, above which a tax rate of 19% is applied. In Estonia (although changes to corporate tax rates

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21 In Hungary, the general corporate income tax rate is 9%, the lowest in the European Union. Besides, local governments are entitled to levy local business tax (of a maximum of 2%), which is included in the value of 10.8. Meanwhile, actors in certain sectors (especially utilities) are required to pay special sectoral income taxes. For local business tax and other Hungarian local taxes, see: Gábor Kecső, "Reforms of Local Finance and Taxation in Hungary: Milestones and Junctions Since 1990," *Polgári Szemle: Gazdasági és Társadalmi Folyóirat* (Special Issue) 16 (2020): 332–44.

22 The order of countries shows the volume of decrease.

23 Csaba Lentner and Vitéz Nagy, "Public Finance Reforms and Corporate Sector Impact: A Study of Hungary," *Corporate Ownership and Control* 18, no. 3 (2021): 191–200.

24 No data are available for Malta. European Commission, 2022: 50, 51.

25 European Commission, 2022: 49.

26 Éva Erdős and Mónika Kispál, "Development of the Main Features of Hungarian Tax Policy Before and After the Pandemic Period," *Curentul Juridic* 95, no. 4 (2023): 45–59.

and dividend taxation are planned from 2025)[27] and Latvia, CIT is paid only on distributed profits, not earned profits, and from 2021, Poland also introduced it as an optional, lump-sum scheme similar to Estonian CIT.[28]

Table 3. Top statutory corporate income tax rates (including surcharges), 2020, 2022 (%)

	Croatia	**Hungary**	**Poland**	**Estonia***	**Latvia***	**Bulgaria**	**Romania**	**EU-27 average**
Top statutory CIT rate	18.0	10.8	19.0	20.0	20.0	10.0	16.0	21.4
CIT revenues (% of GDP)	2.3	1.2	2.3	1.7	0.7	2.2	1.9	2.4
capital tax revenues (% of GDP)	4.7	5.9	8.9	2.7	2.5	5.0	3.3	7.9

Source: own compilation.[29]

Figure 1 shows that the share of consumption taxes in total tax revenue is above 38% in Croatia, Bulgaria, Latvia, Estonia, Hungary and Romania, well above the EU average. In countries with high consumption tax rates and significant consumption tax revenues, both labor and capital income tax and the revenue derived from them are typically below the EU average (see the examined countries).

The main consumption tax is the harmonized value added tax (VAT). After a period of hikes (2009–2013), the EU-27 average standard VAT rate stabilized and then remained unchanged between 2017 and 2022 at 21.5%.[30] Nonetheless, among the examined countries, only in Hungary (standard rate 27%; reduced rates 18% and 5%) and Croatia (25%; 13% and 5%) is the standard VAT rate above the EU average (21.5%).[31] Croatia

27 "Estonia: Significant tax changes in 2024 and 2025," Ernst & Young Global Limited, accessed April 2, 2024, https://www.ey.com/en_gl/tax-alerts/estonia---significant-tax-changes-in-2024-and-2025.

28 "Poland: Corporate – Taxes on Corporate Income," PwC, accessed April 2, 2024, https://taxsummaries.pwc.com/poland/corporate/taxes-on-corporate-income.

29 European Commission, 2023: 58,

30 European Commission, 2022: 34.

31 In Bulgaria, the standard (and reduced) VAT rates are 20% (and 9%), in Latvia: 21% (5%, 12%), in Estonia: 20% (9%) and in Romania: 19% (9%, 5%). Some countries, such as Sweden 25% (12%, 6%), Finland 24 (14% and 10%) and Greece 24% (13% and 6%) have higher

and Hungary have similar tax structures, with a high share of consumption taxes compared to the EU-27 average, but low taxes on labor and capital. In Croatia, the consumption taxation, and also the VAT tax revenue-to-GDP ratio is the highest in the EU, while the capital (21st) and labor (23rd) tax burdens are at the bottom of the EU ranking.[32] Another interesting feature of the Croatian tax system is the high share of environmental taxes. Hungary comes second in the EU ranking of consumption tax and VAT. In Hungary, in addition to VAT, certain goods and services are subject to special consumption taxes[33] (Hungary has the highest tax burden in the EU for such special consumption taxes). Another specific feature of the Hungarian tax system is a low corporate tax rate,[34] that is 9% (ranked 26th in the CIT tax revenue to GDP ranking), however, the overall taxation of capital is higher (revenues from capital taxes are the 16th in the EU ranking) due to the additional burden on certain sectors (e.g. banking and insurance, energy, pharmaceuticals) – reducing the concentration of the tax system.[35] In Bulgaria, as in Croatia and Hungary, consumption taxes are the dominant source of revenue, and revenues from labor taxation are particularly low relative to GDP (26th in the EU ranking).

Besides, there are some countries where the share of consumption tax revenue in total tax revenue is high, though the standard VAT rate is under the EU average. This may be due to a relatively low total tax burden. This is the case in Romania, where the overall tax burden is only 26.5% of GDP and the standard VAT rate is 19%. Latvia and Estonia also have a higher

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standard VAT rates, and the lowest standard VAT rates are in Luxembourg 17% (8% and 3%) and Malta 18% (7% and 5%). All countries now have a standard VAT rate above the 15% minimum set by the Directive – Council Directive 2006/112/EC of 28 November 2006 on the common system of value-added tax (O.J.E.C. L347, 11 December 2006), 1–118, 97. §.

32 European Commission, 2022: 69–192.

33 Examples of special consumption taxes include the financial transaction tax, insurance tax (formerly accident tax), public health product tax, etc.

34 Szilárd Hegedűs and Csaba Lentner, "Analysis of the Competitiveness of the Hungarian Tax System in an International Environment," *Pro Publico Bono: Magyar Közigazgatás* 10, no. 4 (2022): 56–77.

35 See: Gabriella Csűrös and Dóra Lovas, "The Boomerang Effect: Sectoral Extraordinary Taxes in Hungary (2006–2024)," *Rivista di Diritto Tributario Internazionale (International Tax Law Review)*, no. 1, (2023): 189–217; Péter Darák and Dóra Lovas, "Az adórendszer deszantosai: a különadók," *Jogtudományi Közlöny*, no. 11 (2023): 481–91.

share of consumption taxes than the EU-27 average, especially considering that the overall tax burden is well below the EU-27 average. Estonia has the highest taxes and duties on imports excluding VAT (contributing to high levels of consumption taxation), and the lowest share of property tax revenue compared to the EU-27 average. Both countries have low taxes on capital, which promotes tax competition among former socialist countries. The case of Lithuania and Estonia draws attention to the importance of implicit tax rate, showing low PIT rate while at the same time (especially in Estonia) significant social security contributions paid by employers. While Poland also has a relatively high VAT rate (standard: 23%, reduced rates: 5% and 8%), the high taxation of capital reduces the weight of consumption taxes in the tax system.

Even though the main taxes are labor, consumption and capital taxes, it is worth broadening this analysis to include other taxes, such as property and environmental taxes. The table below also provides instructive data (during the COVID-19 pandemic and before the energy crises) in some former socialist countries already examined in the context of consumption taxes.

Table 1 shows that the share of environmental taxes in tax systems is low, both on average in the EU and in the countries analyzed (although most of them are at or above the EU average!). However, in the former socialist countries, the share of property taxes is lower than the EU average for several reasons.[36] First, under socialism, the state provided housing on a broad basis as a matter of right (with state-owned housing at below-market utility costs). On the one hand, during the socialist era, the state tried to provide housing on a broad basis as a basic right (state-owned housing at below-market utility costs)[37] and public wages were not taxed (e.g. state employment operated with lower wages rather than labor taxes) with a low tax burden, as the economy was based on a different distribution mechanism. After the change of regime, society had to face not only a growing tax burden and significantly increasing market-based utility costs but also a steady increase in property prices aimed at catching up with Western

36 Juraj Nemec and Glen Wright, eds., *Public Finance: Theory and Practice in Central European Transition* (NISPAcee, Bratislava 1997), 134–6.

37 Especially in blocks of flats in towns.

European price levels. Wages, however, have not yet caught up and are lagging. In addition to these historical causes, the high administrative cost of property taxes, in particular value-based property taxes, also impede effective property taxation in former socialist countries.

What was the impact of the COVID-19 pandemic on the tax system of Member States? In case of economic recession or depression, the GDP is expected to decrease faster than tax revenues which increases the tax-to-GDP ratio (tax burden as a share of GDP). The COVID-19 pandemic has had a similar impact on most EU countries. Furthermore, the proportion of revenue from labor taxes increased in all Member States except Hungary,[38] where it decreased by 0.8%, and minor decreases (0.1%) were observed in Finland and Poland.[39] In Hungary, the reason for decreasing labor tax revenues was the reduction of social contributions (paid by the employer).[40] In Poland, the reason was the reduction of personal income tax rates and extending the use of tax relief in the framework of the Polish Deal ("Polski Ład") plan to rebuild the Polish economy after the COVID-19 pandemic.[41]

In 2020, there was a 0.3% drop in corporate income tax revenues as a share of GDP (compared to 2019) associated with the COVID-19 pandemic (driven by the decrease in corporate revenue), but in 2021, the CIT revenue increased (by 0.6% of GDP) compared to 2020 in line with the economic recovery. However, there were also differences at the national level below the EU averages, for example, Latvia saw a decline of about 0.6 percentage points.

In 2020, the share of VAT in GDP decreased from 7.1% to 6.9%, as consumption was heavily affected by the COVID-19 pandemic. This, combined with (temporary) rate cuts on certain products resulted in a decline in VAT revenues.[42] In 2021, VAT revenues increased again both in absolute nominal terms and as a share of GDP (to 7.4% of GDP in EU-27) because

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38 For details, see: Hegedűs and Lentner, "Analysis of the Competitiveness of the Hungarian Tax," 56–77.

39 European Commission, 2022: 31.

40 From 2022, the rate of employer social contribution was reduced from 15.5% to 13%. This was in line with the increase in the statutory minimum wage, which caused additional costs for businesses during the crisis. See: Act LII of 2018 on Social Contribution Tax.

41 "Polski ład," gov.pl, accessed March 2, 2024, https://www.gov.pl/web/polski-lad.

42 European Commission, 2022: 31.

of the increase in consumption that followed the end of pandemic-related restrictions. The same trend is visible for all consumption taxes.[43]

Revenue from environmental taxes takes only a small and declining share of the overall tax revenue. According to the Commission, environmental taxes decreased in 2020 at the EU level.[44] The decline was explained by some of the COVID-19 measures that restricted mobility, which, in turn, reduced the revenue from energy taxes on transport fuels. In 2021, they accounted for only 2.2% of GDP and about 5.5% of total tax revenues in the EU. Energy taxes contributed the most with 4.3% of total tax revenues, transport taxes accounted for 1.0%, and pollution and resource taxes for 0.2%, so energy taxes represent the lion's share of environmental tax revenues, accounting for 78% of total environmental tax revenues. This is the case despite the decrease in energy tax revenues observed during the pandemic.[45]

So far, an outline of general trends and directions for change has been presented. In the following, some EU-level and national responses to crises and megatrends shall be discussed in detail.

4. Tax Policy Responses to Crises and Megatrends in the EU and Some Selected Countries

4.1. Opportunities of Digitalization

Harnessing the potential of digitalization contributes to efficient and effective tax administration (in particular risk assessment, tax audit and enforcement) and can also reduce administrative costs, thus facilitating compliance.

The EU promotes e-taxation, the digitalization of tax administration (such as e-invoicing or Central Electronic System of Payment – CESOP) and enhances the administrative cooperation between national taxation authorities.[46] An excellent example of this is the Council Directive (EU)

43 European Commission, 2023: 131.

44 European Commission, 2023: 16.

45 European Commission, 2023: 108–9.

46 Éva Erdős, "The Current Results and Legal Instruments of the Tax Environment Affecting the Digital Economy in the European Tax Law," *Miskolci Jogi Szemle* 16 (Special Issue), no. 1 (2021): 95–106.

2023/2226 (referred to as DAC 8)[47] amending the Directive on Administrative Cooperation (DAC) 2011/16/EU concerning the reporting and automatic exchange of information on revenues from transactions in crypto-assets[48] and on advance tax rulings for the wealthiest (high-net-worth) individuals.

VAT, harmonized by the EU, is not only one of the most important revenues for Member States and EU budgets. It is also the tax most subject to abuse. According to the European Commission, EU Member States lost around €61 billion in VAT in 2021, compared to 93 billion euro in 2020, and 134 billion euro in 2019.[49] The VAT gap is the estimated overall difference between the expected theoretical VAT revenue and the amount actually collected. Since the EU-wide VAT compliance gap reached the highest level in 2013, VAT compliance gaps have decreased in nearly all Member States. Nonetheless, Latvia, Hungary, Poland and Slovakia recorded an exceptionally large improvement in VAT compliance, with VAT gaps falling between 2013 and 2021 by over 15 pp. Before the reforms, the gaps in these four Member States were significantly above the EU median while currently, they belong to the best performers in the EU.[50] In contrast to these EU countries, Romania has seen a persistent and high VAT compliance gap in recent years.[51] The smallest gaps were observed in the Netherlands, Finland, Spain and Estonia.

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47 Council Directive (EU) 2023/2226 of 17 October 2023 amending Directive 2011/16/EU on administrative cooperation in the field of taxation (O.J.E.C. L, 2023/2226, 24 October 2023).

48 Zsolt Halász, "Legal Issues Related to Virtual Devices in the Field of Tax Law," *Iustum, Aequum, Salutare* 16, no. 4 (2020): 35–44; Zsolt Halász, "Legal Challenges Related to Virtual Currencies Especially in the Field of Taxation," in *Common Challenges Once and Now*, eds. Csaba Zágon and Andrea Szabó (Magyar Rendészettudományi Társaság Vám- és Pénzügyőri Tagozat, Budapest, 2020), 123–32.

49 "Value Added Tax VAT," European Commission, accessed April 2, 2024, https://taxation-customs.ec.europa.eu/taxation-1/value-added-tax-vat/vat-gap_en.

50 European Commission et al., *VAT GAP in the EU – Report 2023* (Publication Office of the European Union: Luxembourg 2023), 31.

51 "Romania: Technical Assistance Report-Enabling the Large Taxpayer Office to Reduce the Tax Gap," International Monetary Fund, Fiscal Affairs Dept., accessed April 10, 2024, https://www.elibrary.imf.org/view/journals/002/2016/284/article-A001-en.xml.

4.2. Energy (Supply) Crisis May Result in Growing Environment Taxes?

For many reasons, 2022 was an extraordinary year across Europe. One proof of this is Council Regulation 1854/2022/EU, adopted in autumn 2022, which, among other things, made it compulsory for all Member States to levy a temporary solidarity contribution on the excess profits of EU companies operating in the energy sector (crude oil, natural gas, coal and refining).

Why was this extra profit tax extraordinary? The EU obliged Member States to levy tax by a regulation (not by a directive), only for actors in the energy sector. The extra profit tax is an additional tax besides the standard corporate tax aiming at the windfall profit, i.e. extra (above average) profit resulting from energy crisis. This is a process in the opposite direction to the tax competition observed in corporate taxation. Even though this tax is a temporary one (planned to operate in 2022–2023), its rate (33%) is a significant takeaway. Being a solidarity tax (serving a redistributive function), it must be used for supporting households, companies in energy-intensive industries, etc., which makes it a Pigouvian (targeted) tax. It also questioned the validity of the principle of non-retroactivity, and thus the principle of legal certainty, since the introduction of extra tax was during the year with regard to the whole tax year.

The use of crisis taxes is not new in European MSs, however, it is exceptional. Besides, as a result of the recent crisis, more Member States have become ready to use this extraordinary tax policy measure (the crisis tax) that is apparently coupled with the permissive attitude of the European Union to state aid rules.

The case of Hungary is a prime example, where the government (ruling since 2010) has introduced crisis taxes to address both previous (2008/9) and current economic crises. In the 2010s, the Hungarian crisis taxes seemed to be a pioneer and hazardous method as the legality of their regulation was the subject matter of a number of EU proceedings (preliminary rulings, infringement proceedings).[52] From 2022 Hungary also levied crisis taxes[53] as extraordinary sectoral taxes, representing a more intensive

[52] For details, see: Gabriella Csűrös, "Tax System in Hungary and its Changes Due to the Crisis – Pioneer or Hazardous Method of Sectoral Taxation?," in *Tax Authorities in the Visegrad Group Countries. Common experience after accession to the European Union*, eds. Marcin Burzec and Paweł Smoleń (Wydawnictwo KUL, Lublin 2016), 85–113.

[53] For details, see: Csűrös and Lovas, "The Boomerang Effect," 189–217.

intervention in market processes than earlier but, appearing to have learnt from past experience, it obtained permission from the EU. Namely, Hungarian crisis taxes have been the subject of fewer EU proceedings and, so far, the crisis taxes have not been considered contrary to EU law. The EU's changing – or inconsistent – approach is visible in the reasoning of the Tesco judgement (2020) after the Hervis judgement (2012).[54]

The energy (supply) crisis has increased energy and green taxes but only as temporary, crisis taxes.

4.3. Green Tax Reform – Missed and Misunderstood

Even if an extra profit tax has been levied on the energy sector under pressure from the EU, it is not essentially for environmental purposes. Green tax reform has not yet been implemented, as environmental taxes represent a low share of tax revenue in all EU Member States (Table 1). The examined Central and Eastern European countries perform in line with the EU average; in fact, most apply environmental taxes (as % of GDP) above the EU average (e.g. Croatia, Latvia).

Nonetheless, in 2011, the Commission proposed that tax systems should be redesigned by broadening tax bases and shifting the tax burden away from labor to tax bases linked to consumption, property and pollution. The desirable green tax reform in line with the 2020 Strategy meant a growing share of environmental taxation in the tax system without raising the total tax burden.[55] In the last decade, the tax structure has not changed substantially, in fact, labor taxes have increased in recent years.

In some EU Member States, there has been a slight shift in tax revenues from labor to environmental taxes between 2002 and 2019 (Estonia, Bulgaria, Latvia, Poland, Romania, Croatia, and six other countries).[56] This is the trend in almost every examined former socialist country, with Hungary being the only country to show a minimum change in the opposite

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[54] CJEU Judgment of 5 February 2014, Hervis Sport- és Divatkereskedelmi Kft. v. Nemzeti Adó- és Vámhivatal Közép-dunántúli Regionális Adó Főigazgatósága, Case C385/12, ECLI:EU:C:2014:47; CJEU Judgment of 3 March 2020, Tesco-Global Áruházak Zrt. v Nemzeti Adó- és Vámhivatal Fellebbviteli Igazgatósága, Case C-323/18, ECLI:EU:C:2020:140.

[55] COM(2011) 168 final, Smarter energy taxation for the EU: proposal for revision of the Energy Taxation Directive, Brussels, 13 April 2011.

[56] Slovenia, Greece, Belgium, France, Finland and Italy.

direction.[57] In contrast, in most of the more economically advanced Western European Member States, tax revenues shifted from environment to labor (especially in Denmark, Germany, Norway, Portugal, and also in EU-27).[58] Regarding the tax bases, environmental taxation should include energy and transport taxation (as pollution and resources have smaller tax bases) according to the EU. More experts[59] suggest that environmental taxes may have a double positive effect as they help to achieve environmental goals by changing behavior and generating public revenue with positive macroeconomic effects.

The Commission proposed a reform of the Energy Tax Directive already in 2021 (in the framework of the European Green Deal), but its adoption is still pending. One of the contradictory provisions of the current Energy Tax Directive is that heavily polluting shipping and aviation (except for private purposes) are exempted from energy taxation. Even though the EU reformed the Emissions Trading System (ETS) and adopted the Carbon Border Adjustment Mechanism (CBAM),[60] what is still missing is the pressure for green tax reform. Even in the last communication of the Commission regarding the management of climate risk and protecting prosperity – there is no mention of the need for urgent or any tax policy actions.[61] After all, environmental taxes also function as behavioral taxes.

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57 For more details on the Hungarian case, see: Kecső Gábor et al., "Fiscal Policies to Mitigate Climate Change in Hungary. Climate and Environment Taxation in Hungary," in *Fiscal Policies to Mitigate Climate Change*, ed. Marilyne Sadowsky (Intersentia: Cambridge, Antwerp, Chicago 2023), 456–84.

58 European Commission, 2023: 110.

59 See: Jaume Freire-Gonzáles, "Environmental Taxation and the Double Dividend Hypothesis in CGE Modelling Literature: A Critical Review," *Journal of Policy Modelling*, no. 1 (2018): 194–223; Maruf Rahman Maxim, Kerstin K. Zander, and Roberto Patuelli, "Green Tax Reform and Employment Double Dividend in European and Non-European Countries: A Meta-Regression Assessment," *International Journal of Energy Economics and Policy*, no. 4 (2019): 342–55.

60 The EU Emission Trading System (EU ETS) is the world's first international greenhouse gas (GEG) emissions trading system and has been in place since 2005. The CBAM: Regulation (EU) 2023/956 of the European Parliament and of the Council of 10 May 2023 establishing a carbon border adjustment mechanism (O.J.E.C. L130, 16 May 2023), 52–104.

61 COM(2024) 91 final, Managing climate risks – protecting people and prosperity, Strasbourg, 12 March 2024.

4.4. Behavioral Taxation

Any tax which aims at inducing a change of behavior in any activity that generates (negative) externalities can be deemed a behavioral tax. Behavioral taxes typically encompass environmental taxes targeting energy, transport, resources, and pollution; and health taxes, including taxes on alcohol, tobacco and other unhealthy food and beverages. According to Kirchler, earmarking could increase acceptance of taxes,[62] and earmarking could at the same time serve as a justification for continued undesired behavior. According to Weber and Herrmann,[63] the public benefit efforts of a state (the "good government") are a major motivator for tax compliance.

Consumer information and price transparency should accompany the introduction of behavioral taxes, to improve social perceptions. It also must be emphasized that sustainable alternatives must be available and accessible and that it is important to consider how different income groups are affected. The possible changes in impacts also need to be taken into account.

An interesting element of the reform of EU budget revenues is the introduction of an obligation for Member States to pay a levy on non-renewable plastic packaging waste from 2021,[64] which could encourage Member States to tax this waste.

Arguably, much more environmental taxation is needed in the form of behavioral taxes than at present, and in order to ensure the sustainability of social security, health protection behavior taxes could also be applied more widely (there are positive examples in the Czech Republic and Hungary).[65]

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62 "The Role of Behavioral Taxation," EU Tax Symposium 2023, accessed April 12, 2024, https://taxation-customs.ec.europa.eu/road-2050-tax-mix-future/eu-tax-symposium-2023_en.

63 Till Olaf Weber, Jonas Fooken, and Benedikt Herrmann, "Behavioural Economics and Taxation," European Commission, Taxation papers. Working paper N 41. 2014, 31, accessed April 10, 2024, https://taxation-customs.ec.europa.eu/system/files/2016–09/taxation_paper_41.pdf.

64 Council Decision (EU, Euratom) 2020/2053 of December 2020 on the system of own resources of the European Union and repealing Decision 2014/335/EU, Euratom (O.J.E.C. L424, 15 December 2020), 1–10.

65 The Act CIII of 2011 introduced the public health product tax in Hungary to reduce the consumption of unhealthy food and to improve the financing of health services and programs (as a targeted tax it is the revenue of Health Insurance Fund).

It must be noted that green reforms can also be facilitated by restructuring public spending both under the EU budget and the Recovery and Resilience Facility from 2020/21 – but everything has its price…

4.5. Risk of Indebtedness in the Short and Long Term

Contending with both the COVID-19 epidemic[66] and the energy crisis has increased government spending in Member States to help economic recovery. The possibility of launching an excessive deficit procedure (EDP; using the general escape clause)[67] has been suspended between March 23, 2020 and December 12, 2023, but from this year (2024), there is a strong possibility of open deficit-based EDPs in spring 2024 for several Member States because of growing public debts and high budget deficit. Also in the framework of the European Semester, the conditions of launching macroeconomic imbalance procedure are examined, and although no Member State has been subject to an excessive imbalance procedure, in 2023 in 12 Member States,[68] imbalances or excessive imbalances were identified and in 2024, another MS (Slovakia) also shows emerging imbalances.[69]

Besides the economic crisis, socio-economic changes (such as an ageing society) and the migration crisis also put public finances under significant pressure.

In addition to the above, the risk of long-term indebtedness is significantly increased by the surge in EU-related loans. The Recovery and Resilience Facility (RRF)[70] provides EUR 291 billion in loans (repayable supports) and EUR 357 billion in non-repayable grants[71] to Member States

66 Erdős and Kispál, "Development of the Main Features of Hungarian Tax Policy," 45–59.

67 See details: Gabriella Csűrös, "Excessive Deficit Procedure: Past, Present, Perfect?," *International Journal of Legal and Social Order*, no. 1 (2022): 87–105; Zsolt Halász, "The Evolution of Fiscal Conditionality in EU Law," *Hungarian Yearbook of International Law and European Law*, no. 11 (2023): 124–35.

68 Cyprus, France, Germany, Greece, Spain, Hungary, Italy, the Netherlands, Portugal, Romania and Sweden. See: COM(2023) 901 final, Annual Sustainable Growth Survey 2024, Strasbourg, 21 November 2023, 3.

69 Ibid.

70 Regulation (EU) 2021/241 of the European Parliament and of the Council of 12 February 2021 establishing the Recovery and Resilience Facility (O.J.E.C. L57, 18 February 2021), 17–75.

71 "Recovery and Resilience Facility," European Union, accessed April 13, 2024, https://next-generation-eu.europa.eu/recovery-and-resilience-facility_en.

to manage the consequences of the COVID-19 crisis, later complemented by the energy crisis. All sources of RRF are loans taken by the Commission from the capital markets (so-called back-to-back loans), to be repaid from the EU budget by 2058 at the latest. Thus, these exceptional and temporary measures will provide aid without increasing the present (!) pressure on Member States' public finances between 2021 and 2026, but the non-repayable grants will have to be repaid later (until 2058) from the EU budget (with underlying national responsibility). This has made it necessary to reform the EU budget's revenue system, for which Commission proposals have already been made, but deadlines are slipping. If the logic of the current revenue structure of the EU budget (mainly GNI-based payments from Member States) is taken as a starting point, the new revenues will decrease the national budgets' revenues or increase the national budgets' expenditures. Loans (as repayable grants) must be repaid by the beneficiary Member State, though the risk of non-repaid loans is ultimately covered by the EU budget – indirectly by the (other) Member States.

Furthermore, to cover loans (so-called macrofinancial assistance) to third countries (see Ukraine),[72] the EU also borrows back-to-back loans from the financial markets and, if the beneficiary does not repay them, the EU budget has to cover them.

To sum up, the temporary (non-repayable) grants of RRF and the EU loans (especially to Ukraine), which have reached unprecedented levels, represent a significant long-term risk for the EU budget and – indirectly – for the budgets of Member States!

72 The EU has already given loans to Ukraine from macrofinancial assistance several times. In 2020–2021 according to 2020/701/EU Decision, EUR 1.2 billion was disbursed in loans. In 2022, according to 2022/313/EU Decision: EUR 1.2 billion, 2022/1201/EU Decision: EUR 1 billion and 2022/1628/EU Decision: EUR 5 billion, totalling EUR 7.2 billion. Under 2022/2463/EU Regulation, a Macrofinancial Assistance+ instrument was founded to provide EUR 18 billion in loans to Ukraine in 2023. Source: "Macrofinancial Assistance to Ukraine," European Union, accessed March 19, 2024, https://eur-lex.europa.eu/EN/legal-content/summary/macrofinancial-assistance-to-ukraine.html. In parallel with loans, EU budget (non-repayable) supports are also given to Ukraine under the Global Europe Neighbourhood, Development and International Cooperation Instrument, established by Regulation (EU) 2021/947. See: "Factsheet: EU Solidarity with Ukraine," European Commission, 30 April 2024, accessed April 2, 2024, https://ec.europa.eu/commission/presscorner/detail/en/FS_22_3862.

5. How to Build the Future Tax Mix in Europe?

The EU relies heavily on labor taxation including social security contributions (accounting for more than half of all EU-27 tax revenues), though it can discourage labor market participation. Besides, ageing, digitalization, global markets, new forms of work and increasing labor mobility question the residence-based principle of personal income tax. The ageing of societies results in a decline in the working-age population at the same time increasing age-related public expenditure which could be relieved by behavioral taxes (linked to, for example, the consumption of unhealthy products or the use of risky services). The reformed social security contributions and increasingly earmarked health taxes could serve as behavioral taxes and increase social acceptance. This could, in turn, contribute to the sustainability of the social security system in Europe.

In the former socialist countries analyzed in this study (Croatia, Bulgaria, Latvia, Estonia, Hungary, Poland and Romania), the tax burden on personal income is lower than the EU average and the implicit tax rate (ITR) on labor is also below the EU average[73] – and exceptionally low in Bulgaria and Croatia. These trends are in line with the Commission's proposed tax policy of reducing the relatively high income tax burden.

Apart from labor taxes, capital income tax revenues are also typically below the EU average in the examined countries. At the same time, the share of consumption taxes in total tax revenue is above 38% in these Member States.

Harnessing the potential of digitalization contributes to efficient and effective tax administration and can also reduce administrative costs, thus facilitating compliance. VAT, harmonized by the EU, is not only one of the most important revenues for Member States and the EU budget – it is also the tax most subject to abuse. Latvia, Hungary and Poland recorded an exceptionally large improvement in VAT compliance, with VAT gaps falling between 2013 and 2021 by over 15 pp. and currently these states belong to the best performers in the EU.[74] Tax administrations in most of

[73] Because of the higher rate of social security contribution in Hungary, it is in line with the EU average.

[74] Romania still faces challenges related to tax avoidance, VAT compliance gap and inefficient tax auditing.

the analyzed countries are therefore well adapted to the challenges of digitalization.

Still, though, in the former socialist countries, the share of property taxes is lower than the EU average (for historical reasons, property taxation is less accepted by their society, and the high administrative costs of value-based property taxes are also an obstacle for effective property taxation). According to a Commission study of 2024,[75] strengthening property taxation would help to make the tax system fairer, although not in a time of high inflation and crisis.

The share of environmental taxes in tax systems is low, both on average in the EU and in the countries examined (although most of them are at or above average). The energy (supply) crisis has led us to growing energy and green taxes but they seem only temporary, as crisis taxes. While the EU allocates significant funds for environmental protection, besides reforming the Emissions Trading System (ETS) and adopting the Carbon Border Adjustment Mechanism (CBAM), what is still missing is the pressure for green tax reform.

The future tax system must implement a desirable green tax reform shifting a part of the tax burden away from labor to tax bases linked to environment taxes and converting more taxes into behavioral taxes. This would result in increasing their social acceptance – regarding the sustainability of the tax system as the European and national budgets face significant financial pressure due to the polycrisis, megatrends and EU loans.

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[75] Áron Kiss et al., "Growth-Friendly Taxation in a High-Inflation Environment," European Commission, European Economy Economic Brief 079, March 2024, 13, accessed April 30, 2024, https://economy-finance.ec.europa.eu/publications/growth-friendly-taxation-high-inflation-environment_en.

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The Weakening of Taxpayer Rights in the Exchange of Information between Tax Authorities

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Abstract: Developments in international legislation and the growing digitalization of tax law support the advancement of global networks between tax authorities. We are witnessing an integration of databases that will lead to increasingly intense coordination of the fight against tax evasion at a supranational level. As in social networks and digital commerce, databases are gradually enriched, contain progressively precise information on the individual taxpayer and use common languages that allow for automated exchanges of information. While waiting for the creation of a global database – not conditioned by the constraints of reciprocity and abstractly usable by all authorized entities who need it – the first risks of limitation of the taxpayer's rights are emerging. In fact, these phenomena have dark sides that are starting to emerge in use, at a national level and with respect to individual taxpayers, of interpolated databases. Moreover, a growing amount of information flows from heterogeneous and increasingly widespread sources, sometimes not protected by the requirements of professionalism, legality and public trust since data collection and entry can be delegated to economic entities, intermediaries and consultants. The absence of an authority responsible for the unitary management of global databases and for the resolution of their conflicts, the slow and timid affirmation (only in some national systems) of the taxpayer's right of access to information concerning them, the difficult configuration of the faculty to request the correction of erroneous data and of the specular public power to remove

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the reported inaccuracies, weaken the system of protections gradually erected to protect the taxpayer's position. In this way, the coordination of national systems that contemporary tax law creates is strongly unbalanced on the side of the protection of tax interests. International and European tax law should instead provide greater guarantees in favor of the taxpayers, defending their right to fair taxation.

1. Opportunities and Risks of the Automated and Mandatory Exchange of Information between Tax Authorities: Introductory Notes

The European legal harmonization in tax assessment procedures has been significantly advanced by the requirement to share information held by national tax authorities and the ongoing expansion of their databases. These phenomena are significantly bolstered by advancements in international tax law, particularly the BEPS project, as well as the rapid proliferation of artificial intelligence in this field.[1] The legal framework of collaboration between EU member states is currently underpinned by the developments in the Council Directive 2011/16/EU (on administrative cooperation in the field of taxation), which establishes all the necessary procedures and provides the structure for a secure platform for the cooperation between European tax authorities.[2]

The basis of the contemporary dialogue is the Common Reporting Standard,[3] a codification adopted in July 2014 by a growing number of

[1] For more details, see: Dennis Weber, *The Implications of Online Platforms and Technology on Taxation* (Amsterdam: IBFD, 2023); Lorenzo Del Federico and Franco Paparella, eds., *Diritto tributario digitale* (Pisa: Pacini, 2023); Roberto Cordeiro Guerra and Stefano Dorigo, eds., *Fiscalità dell'economia digitale* (Pisa: Pacini, 2022); Błażej Kuźniacki et al., "Requirements for Tax XAI Under Constitutional Principles and Human Rights," in *Explainable and Transparent AI and Multi-Agent Systems*, eds. Davide Calvaresi et al., EXTRAAMAS 2022, Lecture Notes in Computer Science, vol. 13283 (Berlin: Springer, Cham, 2022), https://doi.org/10.1007/978-3-031-15565-9_14.

[2] Cf.: Roberto Cordeiro Guerra, Stefano Dorigo, and Antonio Viotto, *L'attuazione della DAC 6 nell'ordinamento italiano. Profili teorici e prospettive future* (Torino: Giappichelli, 2023), 229.

[3] It is based on the Model Competent Authority Agreement (CAA) drafted by the OCSE to disseminate financial data pursuant to Article 26 of the Double Taxation Agreement and Article 6 of the Multilateral Convention on Mutual Administrative Assistance in Tax Matters, which has significantly promoted the automated exchange of such information. For further details, refer to the Automatic Exchange of Information (AEOI) Portal (https://www.oecd.org/tax/automatic-exchange/), which provides updated information on the work of the Global Forum

financial institutions (now over 110) for communication with the respective authorities and the automated exchange of information on financial accounts. Thanks to a common language, the information flows between the different jurisdictions adhering to the agreements become fully usable, also for tax purposes.[4] Furthermore, the control of taxpayers and their economic activities increasingly involves new technologies, and the interoperability of databases favors the integration of knowledge at a European (but also global) level, supporting action to combat tax malpractice more effectively but not always sufficiently attentive to taxpayers' rights.

The role of the taxpayers and their consultants has also changed profoundly in a short time since rather than passively undergoing the control (as happened until recently), they actively participate in it. For example, those who carry out online commercial transactions and those who make use of tax planning tools in cross-border operations must carry out a self-check of the dangerousness and/or opacity of their tax behavior and are today burdened by preventive communication obligations, which constitute a real own advance disclosure of their tax structures.

The increasingly widespread feeling is that privacy, confidentiality in the consultancy field and even professional secrecy – the latter within the limits that CUGE has taken care to specify[5] – are giving way to a new model

on Transparency and Exchange of Information for Tax Purposes in the automatic exchange of information. For further reading, see also: Pasquale Pistone, *Diritto tributario internazionale* (Torino: Giappichelli, 2024), 303; Michael Lang et al., *The OECD Multilateral Instrument for Tax Treaties. Analysis and Effects* (Alphen aan den Rijn: Kluwer Law International, 2018); Stefano Dorigo, "L'impatto della Convenzione multilaterale BEPS sul sistema dei trattati contro le doppie imposizioni," *Rivista Trimestrale Diritto Tributario*, no. 3–4 (2018): 559.

4 About the Common Reporting Standard and more generally on international tax coordination projects, see: Pistone, *Diritto tributario internazionale*, 30–2. For further reading, see also: Pietro Mastellone, "Lo scambio di informazioni tra amministrazioni finanziarie," in *Diritto tributario internazionale*, ed. Roberto Cordeiro Guerra (Milano: Wolters Kluwer, 2016), 249; Stefano Dorigo, "L'ordinamento italiano e la cooperazione fiscale internazionale," in *Principi di diritto tributario europeo e internazionale*, ed. Claudio Sacchetto (Torino: Giappichelli, 2016), 155; Giuseppe Corasaniti, "Lo scambio di informazioni tra presupposti internazionalistici e prospettive applicative," *Corriere tributario*, no. 18 (2015): 1361.

5 Cf. CJEU Judgment of 8 December 2022 (Orde van Vlaamse Balies and Others, Case C-694/20, ECLI:EU:C:2022:963), which highlighted the conflict between the right to confidentiality protected by Article 7 of the Charter of Nice and Directive 2018/822/EU (DAC 6), where the latter establishes the obligation for intermediaries of a cross-border arrangement (or for professionals who nonetheless become aware of it in the exercise of their professional

of socio-economic relations that make verifiable *ex ante* rather than *ex post*, the facts and acts likely to generate taxable income or, at least, to evade or defuse control systems. These are the connotations of a more evolved concept of tax compliance, now referring to the preventive phase, to the monitoring of individual conduct and therefore prior and functional to the triggering of specific control actions, which reduces the cognitive "sphere of shadow" of the tax authorities and which considers the "transparency" of tax conduct the fundamental value of the relationship between taxpayers and the tax authorities.

Compared to the past, including recent years, information systems now extend beyond merely collecting data for regulatory bodies upon request. Today, they continuously process, cross-reference, and exchange data with other authorities to conduct automated risk analyses.[6] These systems are designed to promptly identify anomalies that may trigger verification activities, reflecting a growing response to widespread concerns about tax malpractice.

2. Strengthening of Control Activities vs Weakening of Taxpayer Guarantees

Positively observing these developments reveals an exponential increase in the volume of information available to tax authorities, along with a proliferation of data sources and continuous reprocessing. This is progressively supported by artificial intelligence, which enhances risk analysis and predictive research concerning tax-related issues. However, these advancements also

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duties) bound by professional secrecy, to inform any "other intermediary" or, in the absence thereof, the "relevant taxpayer" that they cannot fulfill this obligation. For a commentary on the judgment, see: Natalìa Cecconi, "DAC 6: obbligo di notifica degli intermediari e tutela del segreto professionale dopo la pronuncia CGUE dell'8 dicembre 2022," *Tax news*, accessed February 14, 2023, https://www.taxnews.it/Article/Archive/index_html?ida=594&idn=36&idi=-1&idu=-1. For further insights into DAC 6 and the underlying philosophy of the new early disclosure models, see: Gianluca Selicato, "Le comunicazioni preventive secondo la Direttiva 822/2018/ EU: dalla "collaborazione incentivata" agli "obblighi di disclosure," *Rassegna tributaria* (2019): 121.

[6] Cf.: Jian Ruan et al., "Identifying Suspicious Groups of Affiliated-Transaction-Based Tax Evasion in Big Data," *Information Sciences* 477 (March 2019): 508–32, https://doi.org/10.1016/j.ins.2018.11.008; Walter Didimo et al., "Combining Network Visualization and Data Mining for Tax Risk Assessment," *IEEE Access* 8 (2020): 16073–83. https://doi.org/10.1109/access.2020.2967974.

raise concerns about the quality and reliability of the data collected by tax authorities. There are growing fears regarding the effectiveness of taxpayers' rights to access this data and to seek correction of any inaccuracies affecting them. In practice, procedural protections for taxpayers are notably lacking in both international and European law. However, the risks associated with new data acquisition systems for tax purposes should place the taxpayers' right to fair cross-border tax proceedings at the forefront of contemporary international discussions.

The transition to an increasingly widespread database supply system, consistent with the logic of the sharing economy, assigns the burden of communicating to subjects outside the public administration, potentially lacking specific skills or an adequate level of professionalism. Analytical information on third parties (e.g. their users, suppliers and intermediaries) could immediately affect their tax monitoring and risk analyses. For example, the reporting obligations imposed by Council Directive 2021/514/EU (so-called DAC 7), inspired by the Model Rules for Reporting by Platform Operators with respect to Sellers in the Sharing and Gig Economy published by the OECD on July 3, 2020, places the burden on operators of electronic platforms. They mainly concern income from employment and pension payments, compensation, insurance products, as well as income from property, real estate, and financial leasing fees. The level of detail of the information is particularly high, as can be seen in the case of properties put up for income for which the platform manager is required to communicate the address of the "advertised property", its cadastral data, the total consideration paid or credited during each quarter, any fees, commissions or taxes withheld or charged by the intermediary every quarter and the number of days of rental.

Consider, once again, the requirements imposed by the European Directive 2023/2226/EU (so-called DAC 8), in line with the OECD initiative on the reporting framework for crypto assets, imposes on providers of services for virtual currencies, including those issued in a decentralized way, stable coins (including electronic money tokens) and non-fungible tokens (NFTs).[7] Addressing partly new institutions and payment instruments and

[7] On this subject, cf.: Loredana Carpentieri, "Le criptovalute dall'anarchia alle necessità delle regole," *Rivista di Diritto Tributario*, accessed February 13, 2024, https://www.

subject to continuous transformations that highlight the limits of traditional control systems, the OECD Crypto-Asset Reporting Framework (so-called C.A.R.F.),[8] coordinated by the G20, once again aims at automatic exchange and mandatory information acquired by operators in a particularly dynamic sector, following coordination of national strategies and legislation through regulatory schemes and good practices which have required an update of the CRS. Although it is not at all simple to describe the physiognomy of digital financial markets and even to identify each operator, it is clear that, even in this case, the network of subjects required to transfer information to the tax authorities is destined to expand and include intermediaries who may not be familiar with the standards nor adequately organized to ensure the rigor of data processing in the tax field.

Naturally, these sources of science, which may in some cases prove to be imprecise and which the taxpayer may have an interest in verifying, are added to the more reliable ones that the national tax registers and control authorities acquire and process continuously or during verification, implementing increasingly rich databases and of which contemporary regulations aim to ensure growing interoperability.

Precisely as a result of this integration, which is added to the OECD orientation in favor of strengthening the mandatory and automated exchange of the information in question, it may happen that the jurisdiction within which the data is acquired or processed is not the same of residence of the taxpayers and that the national rules that drive these processes do not ensure a system of guarantees adequate to the expectations or legal standards to which they are accustomed. In other words, if, on the one hand, the OECD countries converge on the objective of acquiring and exchanging increasingly timely and abundant in every sector of the economy and finance, to the point of configuring the creation of a global database "open" to the national authorities – although without a body responsible for its management – on

rivistadirittotributario.it/2024/02/13/le-criptovalute-dallanarchia-alle-necessita-delle-regole/; Stefano Capaccioli, *Fisco digitale. Cripto-attività, protezione dei dati, controlli algoritmici* (Torino: Giappichelli, 2023).

[8] "Tax Transparency and International Co-operation," OECD, accessed June 8, 2023, https://www.oecd.org/en/topics/policy-issues/tax-transparency-and-international-co-operation.html.

the other hand, taxpayers could ignore the methods of acquisition and verification of data concerning them or, at least, part of them.

This happens because harmonization and coordination are achieved only on the side of the collection and exchange of information and, therefore, under the aegis of fiscal interest, but not also on that of the rights and guarantees of taxpayers, which instead remains assigned to the protection of national law or, at most, of European law.

3. The Urgency of Ensuring Legal Protection of the Taxpayer in a Supranational Context

In international law, the taxpayers' protections in the tax assessment procedure seem to be secondary compared to the concerted global efforts to address fiscal malpractice. The effort to seek legally binding protection of rights susceptible to being damaged by the use of digital technologies and the massive exchange of information leads far back in time and, more precisely, to Article 12 of the Universal Declaration of Human Rights of 1948, according to which: "No one shall be subjected to arbitrary interference with his privacy, family, home or correspondence, nor to attacks upon his honor and reputation. Everyone has the right to the protection of the law against such interference or attacks."[9] This principle, disruptive and innovative after the Second World War, slowly radiated into national and European legal systems[10] in times in which there was no awareness of the complexity of subsequent developments in legal relations nor of the impact of digitalization on ever-increasing societies and economies more globalized.

In the following years, however, the international community did not shine its attention and rigor on these issues, to the point that only in some soft law acts did consideration of some taxpayers' rights emerge as owners

[9] The statement was reiterated and updated in Article 17 of the International Covenant on Civil and Political Rights, signed in New York on December 16, 1966, which states: "No one shall be subjected to arbitrary or unlawful interference with his privacy, family, home or correspondence, nor to unlawful attacks on his honour and reputation. Everyone has the right to the protection of the law against such interference or attacks."

[10] The Strasbourg Convention (Convention 108 of 28 January 1981 of the Council of Europe) on the protection of individuals regarding the automatic processing of personal data constitutes an initial bulwark of guarantees inspired by the Universal Declaration of Human Rights.

of the data processed.[11] For example, *Guidelines for the Regulation of Computerized Personal Data Files*, adopted by the United Nations General Assembly with resolution 44/132 of 15 December 1989, or the subsequent works and resolutions of the *Global Privacy Assembly*[12] on the access by public authorities to confidential data held by private entities, as well as calls from the G20 and the OECD to ensure adequate protection of personal data when using contemporary databases.[13]

In any case, these recommendations generally concern the need to ensure proportionality between the reasons that support public authorities' access to personal data and private databases and the protection of the fundamental freedoms of the individual without directly addressing tax relations.[14] Precisely for this reason, the OECD models and guidelines present serious gaps in terms of taxpayer guarantees, both in the phase of acquiring tax information concerning him and in their subsequent processing. Also, on the side of the right to consult such information, which constitutes the second critical aspect that we set out to investigate, international law appears insensitive to the needs and guarantees of the taxpayers given that the system of rules, recommendations, guidelines and models mentioned above completely ignores the importance of their right of access to the wealth of information concerning them.

Therefore, taxes and the continuous evolution of the procedural schemes do not receive particular consideration, generating gaps in protection that are only partially filled by European law[15] and by the important

11 Regarding this issue, cf. Lorenzo Del Federico, "Agreements, Arbitration and Protection of the Taxpayer in the Evolution of International Tax Law," *Rivista di Diritto Tributario internazionale*, no. 1 (2020): 51.

12 https://globalprivacyassembly.org.

13 Cf. Lorenzo Del Federico and Francesco Montanari, "OECD Approach on Digital Transformation of Tax Administrations and New Taxpayers' Rights," *Rivista di Diritto Tributario Internazionale*, no. 2 (2021): 7.

14 On these matters, see: Veronika Wöhrer, *Data Protection and Taxpayers' Rights: Challenges Created by Automatic Exchange of Information* (Amsterdam: IBFD, 2018), https://doi.org/10.59403/2tc43v0.

15 Cf. Lorenzo Del Federico, "OECD Approach on Digital Transformation of Tax Administrations and New Taxpayer's Rights," in *Digital Transformation of Tax Administrations in the European Union*, eds. Alvaro Antón Antón and Cristina García-Herrera Blanco (Madrid: Instituto de Estudios Fiscales, 2023), 153; Giuseppe Pitruzzella, "Dati Fiscali e Diritti Fondamentali," *Diritto Pratico Tributario Internazionale*, no. 2 (2022): 666.

contribution that the Court of Justice ensures in implementing its principles.

Given that even from a European perspective, the phenomenon of big data and their growing use by the authorities have been examined mostly in relation to data protection, it cannot be denied that the peculiarities of the tax procedure, at least in EU jurisprudence, have received greater consideration.[16] For example, the Berlioz Judgment of the Grand Chamber of the Court of Justice filed on May 16, 2017 in case C-682/15 recognized the fundamental rights enforceable by the taxpayer (and, in particular, that established in Article 47 of the Charter of Fundamental Rights) in the process of exchange of information between tax authorities, even when it reverberates in the sphere of the individual.[17] Moreover, the État luxembourgeois ruling, again by the Grand Chamber of the Court of Justice, filed on October 6, 2020 in joined cases C-245/19 and C-246/19, recognized the right to directly challenge the international tax investigation only to the formal recipients of information requests.[18]

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[16] Cf. Philip Baker and Pasquale Pistone, "BEPS Action 16: The Taxpayers' Right to an Effective Legal Remedy Under European Law in Cross-Border Situations," *European Court Tax Review* 25, no. 5–6 (2016): 340; Angelo Contrino, "Banche Dati Tributarie, Scambio di Informazioni fra Autorità Fiscali e 'Protezione dei Dati Personali': Quali Diritti e Tutele per i Contribuenti?," *Rivista di Diritto Tributario on line*, accessed May 29, 2019, https://www.rivistadirittotributario.it/wp-content/uploads/2019/05/Banche-dati-tributarie.pdf.

[17] Cf. Antonio Perrone, "DAC 6, Efficacia dell'Accertamento Tributario e Trasparenza: Fino a Che Punto Sono Legittimi i Doveri di Disclosure?," *Studi Tributari Europei*, no. 1 (2020): 16; the author values the contribution of the judgment to the affirmation of the principle of "proportionality" in the relationship between taxpayer rights and duties, specifically in "understanding the nature of the rights of individuals affected by the disclosure of information (whether provided by the taxpayer directly or by a third party) and the nature of the legal interest of the State in obtaining such information, with the aim of properly balancing the rights of the former with the interests of the latter."

[18] For an examination of the judicial decision, refer to Luca Costanzo, who highlights that the ruling does not sufficiently clarify the validity criterion for evidence requests established by Directive DAC 1 (the so-called "foreseeable relevance"), thereby allowing the collection of data that is not directly pertinent to the tax dispute (Luca Costanzo, "La tutela dei diritti del contribuente al crocevia tra cooperazione amministrativa e integrazione eurotributaria," *Rivista di Diritto Tributario*, accessed December 2, 2020, https://www.rivistadirittotributario.it/wp-content/uploads/2020/12/Costanzo.pdf). For further discussion of the same ruling, see also: Chiara Francioso, "Tutela giurisdizionale e 'prevedibile pertinenza' delle informazioni nella cooperazione amministrativa fiscale europea," *Tax news*, accessed October 14, 2021, https://www.taxnews.it/Article/Archive/index_html?ida=466&idn=33&idi=-1&idu=-1.

The European Court of Human Rights, however, in the most recent ruling of 9 March 2023, pronounced on the L.B. case against Hungary (n. 36345/2016), censored the online publication of a list of tax evaders prepared by the Hungarian financial administration, complaining about the lack of balance in national legislation between measures to combat tax evasion and the right to respect for the taxpayer's private and family life.[19]

If it is true that these provisions constitute an important safeguard of the taxpayer's rights, it is also true that they confirm the difficulty of invoking the same rules and principles in tax matters that European law offers for the general protection of personal data. We are referring to the 2000 EU Charter of Fundamental Rights, which, thanks to the 2009 Treaty of Lisbon, has now assumed a binding value similar to that of the Treaties (see Article 6 of the TEU). Article 8 establishes that: "Everyone has the right to the protection of personal data concerning him or her." Additionally, "such data must be processed fairly for specified purposes and on the basis of the consent of the person concerned or some other legitimate basis laid down by law." Therefore, underlining the importance of a right of access, which, however, continues to suffer significant limitations for the taxpayer, the law adds that: "Everyone has the right of access to data which has been collected concerning him or her, and the right to have it rectified." Finally, it assigns control by an independent authority to verify compliance with these rules.

The time seems ripe to decide how these precepts can be translated into direct and immediate guarantees in the regulation of tax relations, within broader reasoning on the urgency of adopting, at least at the European level, a Charter of Taxpayers' Rights attentive to the issues and the peculiarities of "digital tax law".[20] Yet, despite the Court of Justice's invitation to consider

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[19] On the prior ruling of the same European Court of Human Rights, with the judgment of 12 January 2021, also concerning the case L.B. v. Hungary, albeit case no. 26345/2016, cf. Alessandro Marinello, "Pubblicazione di Dati Personali dei Contribuenti e Rispetto della Vita Privata secondo la Corte EDU: La Difficile Ricerca di un Equilibrio tra Interesse Fiscale e Diritto alla Riservatezza," *Rivista di Diritto Tributario* 32, no. 1 (2022): 12.

[20] The efforts in this area are outdated and only partially effective. In February 2013, the European Commission initiated a public consultation on the development of a European taxpayer code, focusing on taxpayers' rights and obligations as well as the powers of tax administrations. Following this public consultation, at the end of November 2016, the European Commission published the "Guidelines for a Model European Taxpayer Code",

the protection of the taxpayer in the automated exchange of information in unitary, advanced and concrete terms, the greater consideration that, in terms of positive law, intra-EU administrative cooperation receives remains evident, favored by the incessant maintenance and integration of Directive No 2011/16/EU of 15 February 2011 (so-called DAC 1). However, the protection of the taxpayer is completely fragmented and without a defined framework of rules, although it should pervade the developments of the EU regulation of the acquisition and exchange of information of a fiscal nature.[21]

4. Conclusions

This distinct consideration, which, in international law even more than in European law, assumes administrative cooperation with respect to the protection of taxpayers in the phase of collection and use of their information, determines consequences of considerable importance on a practical level.

It is difficult to avoid, for example, the physiological temporal delay between the moment in which the authorities acquire the data relating to the taxpayer and the moment in which this information becomes verifiable by the interested party, even to ascertain its completeness and integrity, authenticity and fairness. In the absence of a universal mechanism that allows the taxpayers to be aware of the acquisition of their data and to request any correction, in fact, the first moment in which they will be able to physically know and verify the contents of the databases will be the one in which the information will be used against them in the procedure for implementing the levy regulated by national law. So that, in the event that

a non-binding document addressed to member states. Although the European response to a global issue remains inadequate, it is to be hoped that the intention to achieve European codification can be further developed and adapted to emerging issues in digital tax law.

21 In the article of Angelo Contrino, "Spinte evolutive (sul piano sovranazionale) e involutive (a livello interno) in tema di bilanciamento fra diritto alla protezione dei dati dei contribuenti ed esigenze di contrasto dell'evasione fiscal," (*Rivista di Diritto Tributario* (October 2023), accessed October 23, 2023, https://www.rivistadirittotributario.it/2023/10/03/spinte-evolutive-sul-piano-sovranazionale-e-involutive-a-livello-interno-in-tema-di-bilanciamento-fra-diritto-alla-protezione-dei-dati-dei-contribuenti-ed-esigenze-di-contrasto-dellevasio/) in which the author provides a thorough analysis of the most recent judicial developments concerning taxpayer data protection and the balancing of this need with the objective of combating tax avoidance.

said information is not referred to in the act or measure in question, but also in the case in which the same remains "latent" as it is used to feed mere risk analyses or other officious checks whose results are not communicated to the taxpayer, a grey area will emerge which is ill-suited to the climate of growing transparency and tax compliance which pervades the most recent developments in national legislation.

The legitimate interest of the taxpayer in demanding the correction of the error, in these hypotheses, could be confined to a mere expectation of protection without concrete legal protection in international law, as there are no superordinate bodies capable of ensuring access to information at universal nor suitable institutions to allow the effective removal of the error contained in the databases, not even in the face of a reasoned request from the interested party. Furthermore, even on a practical level, error correction presents new problems that deserve greater consideration in the developments of the subject and in international guidelines. The main difference compared to the traditional methods of processing information by the tax authorities consists, in fact, in the transition underway from national databases, governed by professional managers and involving a network of responsibilities also in relation to the correctness of the data stored, for example, one based on databases that feed each other or that are more simply replicated but which, however, are not automatically interfering. In other words, nothing guarantees that the correction of the data at a national level will produce direct effects (also) in the distinct jurisdiction, which has, in any case, stored the same data within its own IT systems. Furthermore, there are no legal constraints of a supranational nature aimed at ensuring the adequate "maintenance" of digital infrastructures, nor subjects authorized to access databases established within different jurisdictions in order to monitor, according to shared criteria, the quality and coincidence of stored information.

Apart from the hypothesis, which appears remote outside the Euro-unitary perimeter, of a direct sharing of the databases, the picture does not seem destined to improve even as a result of the possible acquisition of the data within specific "blocks" pertaining to a "distributed" system of validation and guarantee of the preservation of its integrity. We are referring to the blockchain, which is also starting to be talked about in the tax

sector[22] but whose critical profile, from the perspective of this investigation, would remain the preclusion of unilateral corrections of any errors.

Given the "headless" nature of the global information system, which contemplates minimal margins of interoperability of the databases, the tax authority of the relevant national legal system thus remains the sole safeguard of the taxpayer's guarantees, albeit within the limits of their legal protection in domestic law. However, it acts as a mere vehicle for access to the more or less effective defenses that each system provides against the illegitimate acquisition, possession and processing of personal information, as the conditions for achieving a more noble and appropriate coordination between the authorities are not yet in sight, national, whose urgency is also felt.

The amorphous and partly spontaneous models of databases formed in recent years, therefore, encounter the further limit of the absence of direction and networks of roles and responsibilities in the management of data whose sources, as has been said, should at least be verified. And it is not even said that the solution of "sterilization" of the anomalous data (e.g. the erroneous communication concerning rent for an apartment managed through an electronic platform) in the procedural stage constitutes an adequate remedy for the reasonable claims of impartiality and non-discrimination of the taxpayer. The scrutiny of the administrative action should, in fact, go as far as the phases prior to that of its actual use in consultation with the taxpayer and also address the non-participatory activities that take place in its analysis and processing for monitoring purposes and, above all, impulse and direction of subsequent checks.

The strategic activity of risk analysis, which increasingly uses artificial intelligence, can also lead to altered and even discriminatory results

22 On this topic, see: Andrea Quattrocchi, "Le potenzialità applicative della blockchain e dei database condivisi nell'attuazione della norma tributaria," in *Rivista di Diritto Tributario*, accessed November 22, 2022, https://www.rivistadirittotributario.it/wp-content/uploads/2022/11/Quattrocchi.pdf. The author explains the features of blockchain, noting that each participant in the "chain" acts as a "node" with a "public and a private key," which allows them to conduct transactions using a "distributed" and "non-centralized" validation system, in contrast to conventional systems that require a certifying authority. Moreover – and this is particularly relevant to our discussion – "once recorded, transactions – stored in 'blocks' utilizing multiple public ledgers – cannot be altered by any single participant, necessitating the involvement of all parties for any modification."

whenever there is an error or incompleteness in the data used by the algorithms. But even in the cases in which such data is complete and correct, it is not at all certain that the national tax authority is able to provide sufficient information to ensure a critical examination of the genesis, legitimate acquisition and authenticity of the information processed, especially in the cases in which the same was acquired in a different jurisdiction. Nor can it be taken for granted – and indeed, on the contrary, it seems unlikely – that the official who speaks with the taxpayer (perhaps in the intra-procedural cross-examination) has sufficient elements to illustrate the logic underlying the artificial intelligence algorithms, also for the objective difficulty in reconstructing, a posteriori, the path followed with probabilistic analysis methods.

The set of these questions and doubts identifies the tip of an iceberg of emerging legal issues to which each system will need to offer adequate answers, with the risk of a fragmentation of the taxpayers' rights (even of the same taxpayer, where exposed to the contextual and parallel assessment action within two or more different jurisdictions) which would instead encounter a barrier in the affirmation of a more defined and satisfying procedural dimension of international tax law. Instead, this profile of supranational tax law currently appears confined to the prevention of international double taxation, to the interference caused by adjustments to transfer prices and to the related juridical disputes,[23] with a concerted effort between the tax authorities appearing completely unbalanced on the interest side tax and action to combat the erosion of tax bases.[24]

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[23] For a detailed discussion on this topic, see: Del Federico, "Agreements, Arbitration and Protection," 51.

[24] For a contemporary investigation into these issues, see: Chistian Califano, *L'arbitrato e gli strumenti di risoluzione delle controversie nel diritto tributario* (Milano: Giuffrè, 2024).

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Value Added Tax on Financial Services in the EU: The Complete Story

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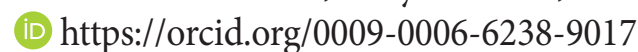
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Abstract: The paper provides an extensive overview of the VAT exemption of financial services in the EU. The topic is surrounded by conceptual and practical challenges. The main issues are presented in a retrospective plan. They have been clearly defined and discussed since the very inception of the EU VAT system. The difficulties this tax regime is faced with today reveal the logical sequence that can be traced as far back as the 1970s. In its first part, the paper looks at the topic from a historical perspective, exploring the inclusion of financial services within the scope of the first VAT rules. Further insight is subsequently provided on the application of the VAT exemption over the past decades until the present-day rules. At its core, the text relies mostly upon the CJEU case law. Capital issues for VAT fiscal neutrality are also given careful consideration. This is the major concern inspiring the Commission's attempts and proposals for VAT reforms. After a concise examination of the efforts to revise the legislation, the paper focuses on the most recent developments in the financial industry, which is a major stakeholder concerned by the recent aspirations of Brussels.

1. Introduction

The article addresses the topic of the recurring ambitions that from time to time inspire the European Commission (EC) to propose a VAT reform in

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the area of financial services.[1] The revision is envisaged to reshape the European VAT system by bringing the supplies of financial services under its rulings for taxable transactions. The principal difficulty for the taxation of these supplies lies in the identification of the taxable amount.[2] The paper provides evidence that initiatives seeking to treat supplies of financial services as VAT-taxable transactions are not modern inventions. Such aspirations are rather a natural inclination inherent to the VAT system since its very first conception. As a second step, the article reviews recent proposals that the EC has been launching since the mid-1990s. In this context, attention will be paid to the latest ideas expressed among financial service providers in their capacity as stakeholders. These reform efforts have their origin in the First and the Second Directives of 11 April 1967 on the harmonisation of legislation of member states (MS) concerning turnover taxes.[3]

2. Early VAT on Financial Services and Its Evolution to Date

Pursuant to Article 19 of the Second Directive, the Council had to adopt appropriate actions to progressively restrict or abolish measures adopted by MS in derogation from the common VAT system. Such measures also included the way MS treated financial services for VAT purposes. A step forward in this regard was made on 9 December 1969 when the Council adopted a resolution that insisted all retail sales be covered under the VAT scope of application as soon as it had been introduced at the national level. On 21 April 1970, the Council decided to replace the MS contributions to the Communities' budget with the Communities' own resources.[4] The latter also include incomes accruing from VAT. In line with that, the EU rules

[1] The generic term "financial services" covers a wide range of financial supplies. Cf. Harry Grubert and Richard Krever, "VAT and Financial Services: Competing Perspectives on What Should Be Taxed," *Tax Law Review* 65, no. 2 (2012): 203.

[2] Rita de la Feria, "The EU VAT Treatment of Insurance and Financial Services (again) under Review," *EC TAX Review* 16, no. 2 (2007): 74.

[3] Cf. First Directive 67/227/EEC of 11 April 1967 on the harmonisation of legislation of MS concerning turnover taxes (O.J.E.C. 1301/67, 14 April 1967, p. 14–15); and Second Directive 67/228/EEC of 11 April 1967 on the harmonisation of legislation of MS concerning turnover taxes – Structure and procedures for application of the common system of VAT (O.J.E.C. 1303/67, 14 April 1967, p. 16–23).

[4] Decision of 21 April 1970 on the replacement of financial contributions from MS by the Communities' own resources (O.J.E.C. L094, 28 April 1970, p. 0019–0022).

were supposed to determine an identical scope of application for VAT under national legislation. Charging VAT on financial services should be examined as part of that principal conception, which relies upon the interdependence of economic activities within a single European market. This implied, above all, that the said services would be delineated and defined in the same manner within the common market. Only this could ensure their identical tax treatment.[5] The EU market transformed into "an area without internal frontiers" with the adoption of the Single European Act.[6] It led to the establishment of a temporary VAT regime for intra-community transactions, which was to be replaced by a definitive system by 31 December 1996.[7] Yet, this transitory regime still applies today.

VAT chargeability on financial services has been part of the EU's agenda for a long time. A discussion on the issue can be traced back as far as before the very inception of the VAT system set up under the First and the Second Directives. The First Directive set out a replacement of the MS' turnover taxes with a VAT system allowing deduction of input VAT. The Second Directive set forth the structure of the tax and the way it should have been charged. As to the VAT exemptions and rates, under those acts the MS applied a wide variety of solutions at domestic level. Until the entry into force of said directives across the six EEC MS, excluding France, financial services were subject to cumulative multistage taxes of various kinds.[8] Throughout the multiple discussions at the EU level addressing various drafts of the Second Directive financial services faced uncertain fates for a long time. Meanwhile, it was decided within a fairly short space of time that a special tax on insurance contracts should be maintained. In the end, financial services were not included in the supplies of services list annexed to the Second Directive.

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5 Gérard Hutchings, *Étude. Les opérations financières et bancaires et la taxe sur la valeur ajoutée*, Série Concurrence – Rapprochement des législations, no. 22 (Bruxelles: Office des publications officielles des CE, 1973), 3.

6 Single European Act (O.J.E.C. L169, 29 June 1987).

7 See: Article 28l of Directive 91/680/EEC of 16 December 1991 supplementing the common system of VAT (O.J.E.C. L376, 31 December 1991, p. 0001–0019).

8 Hutchings, *Les opérations financières*, 11–4. See also: Frédéric Tristram, "Un impôt au service de l'économie. La création de la taxe sur la valeur ajoutée, 1952–1955," in *L'impôt en France aux XIXe et XXe siècles*, eds. Maurice Lévy-Leboyer, Michel Lescure, and Alain Plessis (Vincennes: IGPDE, 2006), 195–231.

Since the adoption of the First and the Second Directives, all EEC MS, except for Belgium to some extent, retained in their national VAT systems the same concepts that were underlying their previous tax regimes. It appeared that, in those states, the conditions that predominated under former taxation rules were simply reproduced or replicated. In fact, the financial activities were not brought under the new common taxation rules. A major drawback was that the reproduction of the old rules, notably wide exemptions, did not have the same impact under a regime of a single tax, such as the VAT, as within a system of cascading taxes. Tax exemptions protected suppliers of financial services from obligations and technical complications. At the same time, exemptions stripped those suppliers of the right to deduct input VAT that had been incurred at earlier stages of the production and distribution chains. Above all, the tax exonerations that were maintained did not allow exempted suppliers to forward any right of deduction to their clients. If the latter were VAT-taxable persons, additional taxation occurred at the final stage of the transactions sequence every time there was a "break" within the VAT credit chain.[9] Thus, cascading taxation was restored to a certain degree. However, the principal goals behind the common system were as follows: (1) to set up a neutral taxation system at the single-state level; and (2) to abolish the pre-existing forms of cascading taxes.[10] The implementation of the two directives led to the general finding that they did not contribute to the spontaneous rapprochement of the MS' taxation methods on financial services. In fact, these directives were silent in this respect. That finding found expression in two final observations. Firstly, the overwhelming majority of financial services were not affected by VAT any more than they had been by former taxes. Secondly, the delimitation of taxable operations, the tax base assessment methods, as well as the options for deduction often gave an impression of high complexity. This

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9 On some negative effects when the VAT chain is broken and a comparison in this regard with turnover taxes or single-stage sales taxes, see: Michael Keen and Ben Lockwood, "The Value-Added Tax: Its Causes and Consequences," *IMF Working Papers*, no. 183 (1 July 2007): 6, https://doi.org/10.1016/j.jdeveco.2009.01.012.

10 Fabrizio Borselli, "A Sensible Reform of the EU VAT Regime for Financial Services", *International VAT Monitor – IBFD*, no. 5 (Sept./Oct. 2009): 378–9. See also: Alan Schenk and Howell H. Zee, "Treating Financial Services under a Value Added Tax: Policy Issues and Country Practices," *Tax Notes International* 22 (June 2022): 3310–1.

clearly explains the initial reluctance on the part of the financial industry to adopt VAT.[11]

In the aftermath of the First and the Second Directives, the EEC states appeared to be facing the following two options: (1) to have a special tax imposed on them in place of VAT; or (2) to integrate all financial activities within the VAT system. The second option gave rise to two further alternatives: whether (1) to include, in principle and formally, the financial services under the VAT application; or (2) to lay down what would in fact be exemptions on the financial services and possibly special rules on them. At the time, the Council decided not to list these services in Annex B to the Second Directive simply on account of the understanding that this would spare obligations to the MS and leave them gradually adapting to the new taxation rules. Thus, the exemption approach was given preference over all other options.[12]

Financial services were first included under the VAT rules with the adoption of the Sixth Directive.[13] However, the document did not define or clarify the exempt services. This legal flaw subsisted since 1977 and has been reproduced over decades. Eventually, the EC indicated it as a ground for its proposal to update the VAT rules for financial and insurance services made in 2007.[14] The EC also pointed out that their inconsistent

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[11] Hutchings, *Les opérations financières*, 14–5; Björn Matthiasson, "The Value-Added Tax," *Finance & Development* 7, no. 001 (1970), accessed January 22, 2024, https://www.elibrary.imf.org/view/journals/022/0007/001/article-A007-en.xml. Burnod aptly notes that an exempt BtoC supply is more favorable than an exempt BtoB supply due to the loss of deduction rights in the latter case. See: François-René Burnod, *Le cadre juridique de la taxe sur la valeur ajoutée*, Conseil des Prélèvements Obligatoires, November 2022, accessed January 22, 2024, https://www.ccomptes.fr/system/files/2023-02/20230209-TVA-rapport-particulier-1_0.pdf. In 2010 the EC launched the idea of a European tax on financial activities chargeable on the profits and remunerations paid by financial entities, but the initiative was abandoned. See: Laurent Quignon, "Spécificités et évolution récente de la fiscalité bancaire," *Revue d'économie financière* 131, no. 3 (2018): 89–106.

[12] Hutchings, *Les opérations financières*, 33–4.

[13] Sixth Directive 77/388/EEC of 17 May 1977 on the harmonization of the laws of the MS relating to turnover taxes – Common system of VAT: uniform basis of assessment (O.J.E.C. L145, 13 June 1977, p. 1–40).

[14] Cf. "Exemptions without the right to deduct," Directorate-General for Taxation and Customs Union, accessed January 22, 2024, https://taxation-customs.ec.europa.eu/exemptions-without-right-deduct_en.

application and overreliance on the case law to fill the legislative gap and provide clarifications was a "current problem with the rules". The Sixth Directive was repealed by the present-day VAT Directive (the VAT Directive).[15] The enumeration in the latter replicates word for word the texts in the Sixth Directive, with the sole exception of factoring. Factoring is one of the forms that debt collection could take and should be treated as a VAT-taxable transaction.

3. Current State of Play and Issues

Financial services give rise to VAT complications since they consist of providing intermediation, which is often rendered for implicit fees. This makes identifying the taxable value added a tight exercise.[16]

3.1. Insurance and Reinsurance Transactions

The first place in the list of exempt financial services in the VAT Directive is assigned to the insurance and reinsurance industries. Their function is to reduce, through risk pooling, the financial impact of a risk for individuals and businesses. Reinsurance protects insurers against very large claims and helps them obtain an international spread of risk. This type of service has its specific peculiarities, which justify its being set apart from the other financial services in the VAT Directive.[17] However, determining the price of premiums for VAT purposes is not an easy task.[18] Thus, Article 135(1)(a) of the VAT Directive exempts insurance and reinsurance transactions, including related services, from VAT. This means that no VAT is chargeable on insurance and reinsurance premiums. As far as the payment of damages is concerned, it is in principle outside the scope of VAT as not being by nature a consideration for a supply. What is more of an issue, is that the VAT

15 Directive 2006/112/EC of 28 November 2006 on the common system of VAT (O.J.E.C. L347/1, 11 December 2006).

16 Schenk and Zee, "Treating Financial Services," 3309; Otto Altenburger, "Applying VAT to Financial Services: Is the New "mobile-ratio model" Adequate for Insurance?," *Zeitschrift für die gesamte Versicherungswissenschaft* 111 (2022): 354, https://doi.org/10.1007/s12297-022-00532-5.

17 Joel Swinkels, "EU VAT Exemption for Insurance Transactions," *International VAT Monitor – IBFD* (July/August 2007): 262 et seq.

18 Cf. de la Feria, "The EU VAT Treatment," 74. See also: Schenk and Zee, "Treating Financial Services," 3309, 3315.

Directive does not provide clear guidance on this exemption. The group of exempted suppliers is not exhaustively delineated, as only the nature of the services provided is of relevance. The transactions carried out by insurers, including with reinsurers, multi-level intermediaries, and sub-intermediaries, that are not VAT-exempt remain a grey area. These issues are already addressed in the CJEU case law, which, since the mid-1990s, has been consistently asked to rule on the scope of exemptions.[19] But even in cases where rulings have been delivered, there are still situations where MS diverge in their application. One such example is the case of *Arthus Andersen*. It is flagged in the literature that, unlike continental EU MS, Ireland and the UK, departing from a literal interpretation, had ignored the outcome of the said case.[20]

3.2. Granting and Negotiation of Credits

This exemption is settled in Article 135(1)(b) of the VAT Directive. Its scope is clarified in the case law.[21] It applies to credits granted by banks, financial institutions, and possibly by other taxable persons. Granting a deferral of payment for a supply of goods and services in return for payment of interest may be equated to granting of credit and therefore deemed exempt. However, this would not be the case, if the payment of interest was restricted to the day of delivery. Also, a third party, which manages the granting of credits but is different from the person granting them, does not perform exempt supplies. VAT experts remarked that this is an unjustified limitation that affects credit institutions resorting to securitization.[22] Moreover, it should be noted that charging VAT on credit interests would lead to double taxation.

19 de la Feria, "The EU VAT Treatment," 81.

20 Ad van Doesum, Herman van Kesteren, and Gert-Jan van Norden, *Fundamentals of EU VAT Law* (the Netherlands: Wolters Kluwer, 2016), 286–8. Cf. CJEU Judgment of 3 March 2005, Staatssecretaris van Financiën v. Arthur Andersen & Co. Accountants c.s., Case C- 472/03, ECLI:EU:C:2005:135.

21 Key CJEU cases are: C-281/91 (Muys' en De Winter's Bouw- en Aannemingsbedrijf BV); C-453/05 (Ludwig); C-276/09 (Everything Everywhere); C-381/09 (Gennaro Curia); C-93/10 (GFKL Financial Services); C-130/15 (NEC / Bookit C-607/14, NEC C-130/15, Cardpoint C-42/18); C-208/15 (Stock '94); C-692/17 (Paulo Nascimento Consultin); C-235/18 (Vega International); C-695/19 (Rádio Popular); C-801/19 (FRANCK); C-250/21 (O. Fundusz lnwestycyjny zamknięty reprezentowany przez O).

22 van Doesum, van Kesteren, and van Norden, *Fundamentals of EU VAT Law*, 288–9.

This should be an outcome contrary to the very purpose of VAT. The granting of credits is aimed at ensuring the availability of funds for the purchase of goods and services the prices of which include VAT charged. The amount of this VAT is therefore taken into account in the calculation of the credit interests. The latter can thus be considered VAT charged for the first time. A double taxation would occur if another VAT were to be charged on the payment of the credit interests.[23]

3.3. Credit Guarantees

The next financial service under exemption is provided for in Article 135(1)(c) of the VAT Directive. Bank guarantees definitely fall under this provision, although the term "guarantee" is not defined by the VAT Directive, or by the CJEU. Non-pecuniary obligations are excluded from this exemption as it should be enabled only in cases of related financial transactions.[24]

3.4. Current Accounts, Payments, and Transfers

This exemption is laid down in Article 135(1)(d) of the VAT Directive. As for all exemptions, the criteria for applying this one are defined by the CJEU. The leading case clarifying the situation is *SDC*.[25] The services under this exemption should form a distinct whole and fulfil the essential functions specific to an exempt service. Transactions involving transfers should have the effect of transferring funds and entail changes in the legal and financial situation. Nonetheless, it is reported in the literature that the criteria set out in *SDC* give rise to disagreements between taxpayers and tax authorities.[26] Moreover, the interpretation of the case across the MS tends to differ.[27] The lack of a uniform interpretation is also due to the different language versions. As to the debt collection, which is excluded from the exemption, it should be noted that the term has no legal definition. At the same time, technology led to new service provisions related to payment-handling, which are subject

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[23] Hutchings, *Les opérations financières*, 38–9.

[24] van Doesum, van Kesteren, and van Norden, *Fundamentals of EU VAT Law*, 289.

[25] CJEU Judgment of 5 June 1997, Sparekassernes Datacenter (SDC) v. Skatteministeriet, Case C-2/95, ECLI:EU:C:1997:278.

[26] van Doesum, van Kesteren, and van Norden, *Fundamentals of EU VAT Law*, 290.

[27] Cf. e.g., Aldo Bisioli and Marco Zanetti, "VAT Exemption for Financial Services in the Banking Sector – The Italian Approach," *International VAT Monitor – IBFD* (May/June 2021).

to unclear VAT treatment. In a nutshell, though, it is known from settled case law that factoring qualifies as a service that is subject to VAT.[28] The exemption at issue does not apply to the following: transfers for consideration of a portfolio of life reinsurance contracts;[29] collection and processing of payments on behalf of clients;[30] additional fees charged when using certain methods of payment for mobile telephony services;[31] electronic messaging services for financial institutions (SWIFT);[32] sales of discount cards;[33] processing of debit and credit card payments in cases where service providers sell for and on behalf of another entity;[34] technical and administrative services supplied to bank operating cashpoints;[35] payments and transfers by direct debit in execution of subscribed dental payment plans.[36] Some of these services are also treated in the case law in light of other financial exemptions. The purpose of their listing here is to show how increasingly casuistic the matter on the achievement of fiscal neutrality over the VAT-exempt financial services is. To the enumeration above may be added cases resolved to the opposite effect.[37] However, often the case law itself is subject to diverging interpretations and does not always diminish legal uncertainty.

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28 CJEU Judgment of 26 June 2003, Finanzamt Groß-Gerau v. MKG-Kraftfahrzeuge-Factoring GmbH, Case C-305/01, ECLI:EU:C:2003:377.

29 CJEU Judgment of 22 October 2009, Swiss Re Germany Holding GmbH v. Finanzamt München, Case C-242/08, ECLI:EU:C:2009:647.

30 CJEU Judgment of 28 October 2010, Commissioners for HMRC v. AXA UK plc, Case C-175/09, ECLI:EU:C:2010:646.

31 CJEU Judgment of 2 December 2010, Everything Everywhere Ltd v. Commissioners for HMRC, Case C-276/09, ECLI:EU:C:2010:730.

32 CJEU Judgment of 28 July 2011, Nordea Pankki Suomi Oyj, Case C-350/10, ECLI:EU:C:2011:532.

33 CJEU Judgment of 12 June 2014, Granton Advertising BV v. Inspecteur van de Belastingdienst Haaglanden/kantoor Den Haag, Case C-461/12, ECLI:EU:C:2014:1745.

34 CJEU Judgment of 26 May 2016, Bookit, Ltd v. Commissioners for HMRC, Case C-607/14, ECLI:EU:C:2016:355; and CJEU Judgment of 26 May 2016, Commissioners for HMRC v. National Exhibition Centre Limited, Case C-130/15, ECLI:EU:C:2016:357.

35 CJEU Judgment of 3 October 2019, Finanzamt Trier v. Cardpoint GmbH, legal successor to Moneybox Deutschland GmbH, Case C-42/18, ECLI:EU:C:2019:822.

36 CJEU Judgment of 25 July 2018, Commissioners for HMRC v. DPAS Limited, Case C-5/17, ECLI:EU:C:2018:592.

37 For ex., cases C464/12 (ATP PensionService), C-264/14 (David Hedqvist), Case C-801/19 (FRANCK).

Sometimes even judicial rulings raise more questions than they provide answers, creating uncertainty where it did not exist before.[38]

3.5. Currency, Bank Notes and Coins

This exemption is set forth in Article 135(1)(e) of the VAT Directive. It does not apply to platinum nobles.[39] The logic behind it is that it would be unreasonable to tax the means of exchange necessary for private expenditures. The latter represent the consumption for which VAT is designed.[40] Exchange transactions between fiat currencies and units of bitcoin are exempt on this ground too.

3.6. Shares and Other Securities

The exemption is set out in Article 135(1)(f) of the VAT Directive. According to settled case law, it is clear that the mere acquisition of ownership in and the holding of bonds is not an economic activity;[41] whereas the involvement of a holding company in the management of its subsidiaries constitutes an economic activity only if it is accompanied by transactions subject to VAT under Article 2 VAT Directive;[42] the supply of a mere physical, technical or administrative service related to transactions in securities is not exempt;[43] services provided by a credit institution in the form of an issuance guarantee are subject to VAT exemption;[44] transactions relating to portfolio management are not exempt;[45] transactions designed to transfer shares

38 Cf. in this respect van Doesum, van Kesteren, and van Norden, *Fundamentals of EU VAT Law*, 291; See also: de la Feria, "The EU VAT Treatment," 81.

39 Article 46 of Regulation (EU) No 282/2011 of 15 March 2011 laying down implementing measures for Directive 2006/112/EC on the common system of VAT (O.J.E.C. L77/1, 23 March 2011).

40 Cf. van Doesum, van Kesteren, and van Norden, *Fundamentals of EU VAT Law*, 292.

41 CJEU Judgment of 6 February 1997, Harnas & Helm CV v. Staatssecretaris van Financiën, Case C-80/95, ECLI:EU:C:1997:56.

42 CJEU Judgment of 12 July 2001, Welthgrove BV v. Staatssecretaris van Financiën, Case C-102/00, ECLI:EU:C:2001:416.

43 CJEU Judgment of 13 December 2001, Commissioners of Customs & Excise v. CSC Financial Services Ltd, Case C-235/00, ECLI:EU:C:2001:696.

44 CJEU Judgment of 10 March 2011, Skandinaviska Enskilda Banken v. Skatteverket, Case C-540/09, ECLI:EU:C:2011:137.

45 CJEU Judgment of 19 July 2012, Finanzamt Frankfurt v. Deutsche Bank AG, Case C44/11, ECLI:EU:C:2012:484.

between companies which concern immovable property and the transfer of that property are exempt (provided that the MS concerned has not availed itself of the option laid down in Article 15(2)(c) VAT Directive);[46] sales of discount cards are not transactions concerning "other securities" within the meaning of Article 135(1)(f) VAT Directive.

The *SKF* case provides clarifications on exempt transfers of shares by a parent company of all its shares in a wholly-owned subsidiary and of its shareholding in an associated company.[47] In the *Kerr* case, the CJEU sheds light on the term "negotiation" as referred to in Article 135(1)(f) VAT Directive. The case law is abundant and meticulously examined in the literature.[48] However, application-related issues remain. Thus, in a cross-border context, the scope of the exemption on transactions in shares differs between MS. The question regarding the treatment of the sale of minority shareholdings remains unanswered. Another unanswered question is whether services such as asset management and global custody should be regarded as "management" and "safekeeping" of shares in the sense of Article 135(1)(f) VAT Directive. It is clear in this regard that advisory services concerning investments in transferable securities, provided by a third party to an investment management company which is the manager of a special investment fund, fall within the scope of "management".[49] The notion of "safekeeping" is more problematic, though. Its scope concerns the VAT treatment of global custody services. It is duly stressed in the literature that the said services were regarded as VAT-exempt in the UK, whereas in many other jurisdictions global custody services were fully taxed with VAT. A PwC study from 2006 reports that global custody

46 CJEU Judgment of 5 July 2012, DTZ Zadelhoff vof v. S. van Financiën, Case C259/11, ECLI:EU:C:2012:423.

47 CJEU Judgment of 29 October 2009, Skatteverket v. AB SKF, Case C-29/08, ECLI:EU:C:2009:665.

48 Cf. van Doesum, van Kesteren, and van Norden, *Fundamentals of EU VAT Law*, 292–6. See also: Ben Terra, Julie Kajus, and Zsolt Szatmari, "Commentary on European VAT" (IBFD 2023), Global Topics IBFD, 2402–807.

49 van Doesum, van Kesteren, and van Norden, *Fundamentals of EU VAT Law*, 294; CJEU Judgment of 7 March 2013, GfBk Gesellschaft v. Finanzamt Bayreuth, Case C275/11, ECLI:EU:C:2013:141.

services were exempt in 11 MS, taxed in five, and the subject of legal uncertainty in nine.[50]

3.7. Management of Special Investment Funds

The last type of exempt financial services is identified in Article 135(1)(g) of the VAT Directive. Given the fast development of asset management and the increasing share of retail investment, the correct application of this exemption raises critical questions. The CJEU delivered a key ruling on the issue in the *Abbey National* case.[51] It clarified that the concept of "management of investment funds" is an autonomous concept in the EU law, the content of which cannot be changed by MS. The administration and reporting services of such funds provided by a third-party manager are included in the said concept under certain conditions. Services corresponding to the duties of a depositary remain outside the exemption. The ruling on the *JP Morgan Fleming* case provided a framework for the freedom MS have in defining the term "mutual investment funds."[52] The latter should respect the objective pursued by the exemption in question, which is to facilitate investing in securities through collective investment schemes, while at the same time respecting the VAT principle of fiscal neutrality. Other judgments provide further answers, including the following: that investment advisory services performed by a third party on behalf of a management company of a mutual fund are covered by the notion of "management of a mutual fund";[53] that an investment fund in which the assets of a pension scheme are pooled does not come under the concept of a "mutual investment funds," the management of which may be exempt;[54] that a taxable person who has set up a pen-

[50] van Doesum, van Kesteren, and van Norden, *Fundamentals of EU VAT Law*, 295. Cf. PwC, 2 November 2006, "Study to Increase the Understanding of the Economic Effects of the VAT Exemption for Financial and Insurance Services," Final Report to the EC (taxud2005/AO-006), 79.

[51] CJEU Judgment of 4 May 2006, Abbey National plc and Inscape Investment Fund v. Commissioners of Customs & Excise, Case C-169/04, ECLI:EU:C:2006:289.

[52] CJEU Judgment of 28 June 2007, JP Morgan Fleming Claverhouse v. The Commissioners of HM Revenue and Customs, Case C-363/05, ECLI:EU:C:2007:391.

[53] CJEU Judgment of 7 March 2013, GfBk Gesellschaft v. Finanzamt Bayreuth, Case C275/11, ECLI:EU:C:2013:141.

[54] CJEU Judgment of 7 March 2013, Wheels Common Investment Fund v. Commissioners for HMRC, Case C424/11, ECLI:EU:C:2013:144.

sion fund in the form of a legally and fiscally separate entity may be entitled to deduct the VAT he or she has paid on services relating to the management and operation of that fund;[55] that pension funds can qualify as mutual funds for VAT purposes if they are financed by the pension recipients, the savings are invested according to the principle of risk diversification and the investment risk is borne by the members of the pension fund;[56] that the exemption may also apply to the investing of funds in real estate;[57] that a single supply of management services, provided by a software platform belonging to a third-party supplier for the benefit of a fund management company, which manages both special investment funds and other funds, does not fall within the exemption;[58] that tax work and the use of software provided to investment fund management companies are exempted.[59]

There are also many pending requests for preliminary rulings waiting for their answers to the general question of whether the exemption for the management of mutual funds applies to a pension fund.[60] Despite the efforts of the CJEU, the main trouble remains that MS treat investment funds, pension schemes, and third-party service providers differently.[61] The negative impact of such an uneven playing field on economic activities within the common market is a distortion of competition.

4. VAT Reform on the Exemption of Financial Services

To sum up, the VAT issues at stake consist of obsolete and imprecise definitions of the term "financial services" in the VAT Directive, which gives rise to numerous disputes between businesses and tax authorities and to

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55 CJEU Judgment of 18 July 2013, Fiscale eenheid PPG Holdings BV v. Inspecteur van de Belastingdienst/Noord/kantoor Groningen, Case C26/12, ECLI:EU:C:2013:526.

56 CJEU Judgment of 13 March 2014, ATP PensionService A/S v. Skatteministeriet, Case C464/12, ECLI:EU:C:2014:139.

57 CJEU Judgment of 9 December 2015, Staatssecretaris van Financiën v. Fiscale Eenheid X NV cs, Case C-595/13, ECLI:EU:C:2015:801.

58 CJEU Judgment of 2 July 2020, Blackrock Investment Management v. Commissioners for HMRC, Case C-231/19, ECLI:EU:C:2020:513.

59 CJEU Judgment of 17 June 2021, K and DBKAG v. Finanzamt Österreich, Joined Cases C-58/20 and C-59/20, ECLI:EU:C:2021:491.

60 Cf. VATupdate.com. See: CJEU cases C-639/22 (X); C-640/22 (Fiscale Eenheid Achmea); C-641/22 (Y); C-642/22 (Pensioenfonds voor Fysiotherapeuten); C-643/22 (BPL Pensioen); C-644/22 (BPFL).

61 van Doesum, van Kesteren, and van Norden, *Fundamentals of EU VAT Law*, 296–8.

discrepancies in the treatment of financial services for VAT purposes in different MS.[62] In the late 1980s, the concept of the cash flow method for taxation of financial services emerged at the international level. It treats the cash inflows from the said services as taxable supplies and the cash outflows as purchases of taxable inputs.[63] In the mid-1990s, alternative tax treatments of financial services were discussed within the OECD. In the same period, the EC also initiated a review of the EU VAT regime on these services, placing the cash flow mechanism under examination. This method was not welcomed by the legislator or businesses and was not forwarded for further deliberation.[64] Nevertheless, the EC continued to prioritize works on the VAT treatment of financial services and in 2004 convened the so-called *Fiscalis* seminar, aimed at investigating positions of tax authorities and businesses on the possibility of moving towards full taxation of financial services. This resulted in the mobilization of a massive resistance against the initiative. The resistance was so fierce that the possibility has since been abandoned and does not seem realistic any longer.[65]

Against this background of continuous uncertainty, following a public consultation launched in 2006, the EC proposed a Directive in 2007 to update the rules on the matter.[66] According to the Explanatory Memorandum, the proposal was aimed at creating an environment of legal certainty with fewer administrative charges for operators and administrations, as well as at reducing the impact of hidden VAT on the costs of insurance and financial services providers. The proposal points out that a public consultation of stakeholders carried out in 2006 and an independent study commissioned

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62 Borselli, "A Sensible Reform," 375–6.

63 Schenk and Zee, "Treating Financial Services," 3314–5.

64 Actually, the review reflects on the so-called "truncated cash flow method". Cf. de la Feria, "The EU VAT Treatment," 79–81. See also: OECD, "Indirect Tax Treatment of Financial Services and Instruments (1998); Commission of the EC, The TCA System – A Detailed Description" (2000).

65 De la Feria, "The EU VAT Treatment," 81, 87. *Fiscalis* is a training programme set forth by Decision 2235/2002/EC of the EP and of the Council of 3 December 2002.

66 Proposal for a Directive amending Directive 2006/112/EC on the common system of VAT, as regards the treatment of insurance and financial services (Brussels, 28 November 2007, COM(2007) 747 final). A draft regulation was also proposed. Cf. Proposal for a Regulation laying down implementing measures for Directive 2006/112/EC on the common system of VAT, as regards the treatment of insurance and financial services (Brussels, 28 November 2007, COM(2007) 746 final).

by the EC have confirmed the necessity of these objectives.[67] The proposal relied on the observation that intensifying competition was driving economic operators within the single market to resort to common techniques to improve their competitiveness. The financial industry applied measures such as the outsourcing of activities (which lowered administrative and labor costs), pooling of activities (with a cost-sharing intention), and sub-contracting (inserting a supplementary distribution level). These practices created hidden VAT in the cost structure of financial services as less value was created in-house but more was supplied as services by independent third parties to the suppliers of financial products.[68] Such third-party services might have no longer come under the exemption for financial services and were therefore invoiced with VAT. This VAT was often not deductible for the clients because they had no right to benefit from the deduction, as they supplied exempt financial services themselves. Such non-deductible VAT became part of the costs. Thus, the proposal was intended to provide solutions reducing the impact on the said costs.[69]

In 2020, the EC launched a new initiative with the view to creating a roadmap.[70] This was the first stage of a new public consultation conducted as an opinion poll among stakeholders from the financial industry. It took place between October 22, 2020 and November 19, 2020 and was replied to by 28 respondents. The roadmap phase revealed that the EC was envisioning two options for reform: (1) removing the existing VAT exemption; or (2) keeping the exemption but modifying its scope by taxing only some types of services.[71] The second consultation stage was held between February 8, 2021 and May 3, 2021. A total of 468 questionnaires from

67 Cf. PwC, "Study to increase the Understanding of the Economic Effects of the VAT Exemption for Financial and Insurance Services," Final Report to the EC, 2 November 2006 (Tender No taxud/2005/AO-006).

68 Cf. de la Feria, "The EU VAT Treatment," 78–79; Schenk and Zee, "Treating Financial Services," 3310–1.

69 Cf. the Explanatory Memorandum to the Proposal of Directive amending Directive 2006/112/EC (28 November 2007, COM(2007) 747 final), 3–4.

70 EC, "Review of the VAT rules for financial and insurance services" (taxud – C1, Ref. Ares(2020)5770956 – 22 October 2020).

71 Rafaela Pardete, Marcia Santos, and Francisco Leote, "Future VAT Regime for Financial Services from a Stakeholder Perspective: Analysis of the European Commission 2020 Public Consultation's Position Papers," *EC Tax Review* 33, no. 1 (2024): 35.

stakeholders were received during that period. At the time of writing, there have been no further developments on this topic. It is safe to presume that the EC decided to process the survey results without proceeding to adopt a proposal before the upcoming 2024 EP election. Nevertheless, the stakeholders' positions remain valid and of interest.

Publicly accessible as of December 16, 2021, they have been scientifically processed using innovative and reliable research methods such as pre-analysis data processing and AI-generated text mining. Consequently, the responses were divided into four thematic clusters – (1) Investment Funds; (2) General Financial Services (banking sector); (3) Insurance; and (4) Fee-based Services (mostly connected to consumers and credit).[72] This survey unravels the dominant attitudes that can be discerned within the financial industry with regard to the EC consultation. All stakeholders voiced concerns about how end consumers would react to a change in the VAT exemption regime. They all argued that the exemption should be maintained, as it ensures VAT neutrality. Investment companies reckon that the exemption encourages small investors to place their capital in investment funds. They also pointed out possible negative effects on governments' VAT receipts, as some investment fund service fees would still have to be zero-rated, whereas the managers of such funds would at the same time be able to deduct the VAT paid on their costs. As far as the general financial and insurance services are concerned, the respondents expressed the fear that abolition of the exemption would lead to higher prices and a heavier tax burden for final consumers who cannot recover input VAT. A competitive disadvantage would be created for EU companies compared with their counterparts in states that do not have a VAT system. At the same time, respondents within the second cluster suggested that a special right to recover input VAT at a fixed rate could be introduced, thus reducing the hidden VAT incurred by financial service providers.

It was also recognized that the exemption infringes upon fiscal neutrality principles, as many other businesses are entitled to recover input VAT. Moreover, it was proposed that an option to tax on a transaction-by-transaction basis, depending on the providers choice, could be adopted, along with cost-sharing groups. Both these options were already

[72] Pardete, Santos, and Leote, "Future VAT Regime for Financial Services," 37.

on the table at the time of discussing the draft directive from 2007. The lack of harmonization across the Union was also highlighted as a major cause for distortion of competition. As regards the insurance services, their taxation poses serious conceptual problems, as it is difficult to determine on which basis VAT shall be calculated, especially for contracts related to savings accrual.[73] The insurance sector contends that the exemption should be extended to the entire supply chain as a measure reducing hidden VAT. Participants representing this industry warned that introducing a VAT rate other than a zero rate for insurance services would make it imperative to consequently repeal all special taxes applicable to insurance premiums or any other forms of indirect taxation. Otherwise, a double taxation of insurance services could occur. As far as the fee-based services are concerned, respondents backed the view that the said services should only be taxed when companies can easily establish which transactions' fees are taxable. Thus, in their view, the VAT exemption should be maintained without being clarified or simplified.[74]

5. Conclusion

Defining and applying VAT exemptions for financial services is a slippery slope on which tax experts have been decades ago. Few of the proposals concerning the issue conceived over the years have not been discussed already in the 1970s. Any taxation placing a burden on transactions based on securities was considered inappropriate at the time, as it was viewed as detrimental to the general conception of promoting the development of capital markets and widened distribution of securities among the public. The full exemption was fostered as a model offsetting possible drawbacks caused by a system where taxable financial transactions (such as the VAT today) would still have been maintained.[75] In any case, discussions always revolved around two options; namely, the complete removal of exemptions or the introduction

[73] Otto Altenburger, Rudolf Diewald, and Max Göttsche, "The Inclusion of Insurance Services in the European VAT System – A Problem that Cannot Be Solved?," *Zeitschrift für die gesamte Versicherungswissenschaft* 111 (Oct. 2022): 340, https://doi.org/10.1007/s12297-022-00536-1.

[74] Pardete, Santos, and Leote, "Future VAT Regime for Financial Services," 38–40.

[75] Proportional deduction is subject to Article 173 et seq. VAT Directive. See: Borselli, "A Sensible Reform," 375.

of further clarifications. The former was not adopted five decades ago and there is no clear reason why such a measure would be anticipated these days. Consumers would certainly not welcome a VAT reform such as the one proposed by the EC, regardless of the price in hidden VAT passed on to them.[76] As to the suppliers representing the financial industry, their interest in the deduction of a tax credit should not be overestimated. After all, there is no place where an ideal VAT model has been adopted in practice so far.[77]

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76 Cf. in this respect Deloitte, "VAT treatment of financial services," 2021, 3, accessed February 10, 2024, https://www2.deloitte.com/content/dam/Deloitte/nl/Documents/tax/deloitte-nl-tax-VAT-treatment-financial-services-EU-commission.pdf.

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Goals, Effects and Challenges of the Financial Transaction Tax: A Comparative Law Study in France, Italy and Spain

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Abstract: The Preamble of the Spanish Financial Transactions Tax Law establishes that "[t]he shaping of the tax follows the line taken by our neighbouring countries, including France and Italy, thus contributing to greater coordination of these taxes across Europe." In this sense, the Spanish tax shows important similarities with those established in France and Italy in relation to the levy on the acquisition of certain shares and securities representing the capital of a company for consideration. Nevertheless, both the French and the Italian taxes apply to other types of transactions, not covered by the Spanish Law, which is why it is necessary to carry out the corresponding comparative study. Furthermore, the effects that have arisen from the application of this kind of taxes to financial transactions merited a proper analysis in order to determine if the main goals pursued by these taxes have been achieved in an efficient way. In any case, there are emerging tax challenges in financial markets connected, on the one hand, to the use of crypto-assets and distributed ledger technology, and, on the other hand, to the implementation of artificial intelligence and machine learning and the fair taxation of these operations.

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1. Introduction

The controversial idea of establishing a tax on financial transactions[1] at the European Union (hereinafter "EU") level has been gaining prominence for a while now. An example of this is the European Commission's Proposal for a Council Directive on a common system of financial transaction tax and amending Directive 2008/7/EC of 28 September 2011[2] that intended to establish a common tax on financial transactions in all Member States. This attempt failed because the necessary unanimous agreement could not be reached.

Faced with this situation, another group of States continued to pursue this objective. In this context, the European Commission approved, on 14 February 2013, the Proposal for a Council Directive implementing enhanced cooperation in the area of financial transaction tax (hereinafter "2013 Proposal"),[3] which enabled the creation of a tax of this nature in the eleven countries adhering to it, namely Austria, Belgium, Estonia, France, Germany, Greece, Italy, Slovakia, Slovenia, Spain and Portugal. However, on 16 March 2016, Estonia completed the necessary procedures to abandon this initiative.[4]

The main goals of the above-mentioned proposals were: (1) harmonizing legislation concerning indirect taxation on financial transactions, which is needed to ensure the proper functioning of the internal market for transactions in this area and to avoid distortion of competition between its participants across the EU; (2) ensuring that financial institutions make a fair and substantial contribution to covering the costs of the financial crises and creating a level playing field with other sectors from a taxation point of view; and (3) implementing appropriate disincentives for transactions that

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[1] Taxation is a measure to offset negative externalities generated by the financial sector, especially during economic crises. In this area, taxes could be classified as follows: (1) financial stability contribution or bank levy (on some balance components); (2) financial activities tax on total profits of corporations; and (3) financial transaction tax levied on specific operations (Karolina Puławska, "Taxation of the Financial Sector: Is a Bank Levy the Answer to the Financial Crisis?", *Journal of Banking Regulation* 23, no. 4 (2022): 390, https://doi.org/10.1057/s41261-021-00178-w).

[2] COM(2011) 594 final.

[3] COM(2013) 71 final.

[4] See doc. 7808/16 FISC 47 LIMITE.

do not enhance the efficiency of financial markets thereby complementing regulatory measures to avoid future crises.[5]

The subject matter and scope of those proposals[6] were very wide, covering almost all kind of transactions, financial instruments and market stakeholders. In this sense, instruments which were negotiable on the capital market, money-market instruments (excluding means of payment), units or shares in collective investment undertakings and derivatives contracts were levied. Furthermore, those financial instruments that could be traded, either in multilateral trading systems (e.g. regulated markets) or in a bilateral manner (i.e. over-the-counter; hereinafter "OTC"), were taxed. The territorial scope of application was limited, according to the 2013 Proposal, to the precited Member States.

In the 2011 Proposal, the subjection criterion was the "residence principle," meaning that the tax would be due if any party to the transaction was established in a participating Member State, regardless of where it takes place. This criterion was extended in the 2013 Proposal, adding the "issuance principle"; therefore, transactions of financial instruments issued in any of those States would also be taxed.

Both proposals established (as a minimum threshold) a 0.1 % tax rate for transactions in all types of financial instruments, except for financial derivatives which would be subject to a reduced 0.01 % tax rate.[7]

Although the 2013 Proposal has never been implemented, the idea of a common FTT has been regularly discussed at the periodical meetings of the Economic and Financial Affairs Council (hereinafter "ECOFIN"). During the 2019 ECOFIN meeting, the Council was informed of the state of play and the European Parliament's support for the introduction of the FTT as an own resource of the EU budget and based on the French model of the tax.[8] This model, similar to a stamp duty, levies only purchases of shares issued by domestic listed companies with a market capitalization higher than 1 billion euros.

5 Gabriela Lagos Rodríguez, "Financial Transaction Taxes," *EC European Review*, no. 4 (2021): 152–3.

6 Articles (1)–(3) of the 2011 Proposal and Articles (1)–(4) of the 2013 Proposal.

7 Article (8) of the 2011 Proposal and Article (9) of the 2013 Proposal.

8 ECOFIN Report to the European Council on tax issues, 14863/19, accessed April 25, 2024, https://data.consilium.europa.eu/doc/document/ST-14863-2019-INIT/en/pdf.

The Spanish legislator, bearing in mind the aforementioned and pending cooperation procedure, considered the establishment of a tax of this nature at the internal level. Thus, the Spanish Tax on Financial Transactions (hereinafter "Spanish FTT") was approved by Law 5/2020 of 15 October[9] (hereinafter "Spanish FTTL") and came into force on 16 January 2021. Some aspects of this tax have been developed by the Royal Decree 366/2021 of 25 May (hereinafter "Spanish Royal Decree 366/2021").[10] According to the Preamble of the Spanish FTTL, the main goals of the tax are: (1) consolidating public finances; and (2) strengthening the principle of fairness in the tax system of Spain, given that, so far, the transfer of shares and securities representing capital of a company for valuable consideration was not effectively subject to any indirect tax.[11]

The Spanish levy follows the line established in other EU Member States,[12] such as France and Italy, and it has many elements in common with the modalities of the French and Italian taxes on the acquisition of certain shares and securities for consideration, but not with the rest of financial transactions that are levied in these two States.

The following sections of the paper will analyze: (1) the fundamental aspects of the legal regime of the French and Italian taxes, pointing out the similarities and differences with the Spanish levy; (2) the goals, achievements and effects of the FTT in those countries; and (3) the remaining challenges. The paper will conclude with final remarks.

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9 Spanish Official Gazette of 16 October 2020, as amended.

10 Spanish Official Gazette of 23 May 2021, as amended.

11 Currently, Article 314 of Spanish Law 6/2023 of 17 March, on Securities Markets and Investment Services (hereinafter "Spanish SMISL"), provides the exemption for transferring securities from: (1) Value-Added Tax and (2) Transfer Tax and Stamp Duty. Nevertheless, there is a *iuris tantum* presumption that concrete operations on some securities linked to real estate are developed to avoid tax payment and, therefore, must be levied (Spanish Official Gazette of 18 March 2023, as amended).

12 Other EU countries where a FTT has been passed are: (1) Belgium; (2) Cyprus; (3) Finland; (4) Ireland; (5) Malta; and (6) Poland (Gabriela Lagos Rodríguez, "Financial Transaction Taxes," 161 et al.).

2. The French and Italian Taxes as Precedents of the Spanish Tax

2.1. Preliminary Questions

Due to the above-mentioned paralysis of the process of approving a financial transaction tax at the EU level, France enacted its own levy on this type of transactions. Indeed, Article 5 of the 2012 Supplementary Budget Law no. 2012–354 of 14 March (Loi de finances rectificatives pour 2012),[13] modified the French General Tax Code (Code Général des Impôts – hereinafter "CGI") with effect from 1 August 2012.

Initially, the common name of taxe sur les transactions financières (hereinafter "French FTT") included three different modalities or kinds of taxes: (1) tax on acquisitions of equity securities and similar instruments (Article 235 ter ZD of the CGI); (2) tax on cancelled orders in high-frequency trading (hereinafter HFT) (Article 235 ter bis ZD of the CGI); and (3) tax on certain sovereign debt credit default swaps (hereinafter "CDS")[14] (Article 235 ter ter ZD of the CGI).

The goals of the tax are: (1) enabling the financial sector to contribute to the recovery of the French public finances; (2) restricting or limiting the most speculative financial activities; and (3) initiating a movement for the accession of other EU Member States to the Commission's project for a common EU financial transaction tax. Tax on acquisitions of equity securities and similar instruments was intended as a way to raise revenue and consolidate French public finances, while taxes on certain sovereign CDS and on HFT were an attempt to reduce some highly speculative activities.[15]

Nevertheless, the tax on certain sovereign CDS is not currently in force, because the aforementioned Article 235 ter ter ZD of the CGI was repealed

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13 French Official Gazette of 15 March 2012, as amended.

14 According to Article 2(1)(c) of the Regulation (EU) no. 236/2012 of the European Parliament and of the Council of 14 March 2012 on short selling and certain aspects of credit default swaps, a CDS is "a derivative contract in which one party pays a fee to another party in return for a payment or other benefit in the case of a credit event relating to a reference entity and of any other default, relating to that derivative contract, which has a similar economic effect" (O.J.E.C. L86, 24 March 2004). This kind of derivative could be used for hedging the risk of sovereign debt default.

15 "La taxe sur les transactions financiéres et sa gestion," Court des Comptes, July 5, 2017, 1–2, accessed February 20, 2024, https://www.ccomptes.fr/fr/publications/la-taxe-sur-les-transactions-financieres-et-sa-gestion.

by Article 26(V) of the 2019 Budget Law nº 2018–1317 of 28 December 2018 (Loi de finances pour 2019), with effect from 1 January 2019.[16]

For its part, Italy has introduced a tax in this field (hereinafter "Italian FTT") by virtue of Article 1 of Law no. 228 of 24 December 2012, laying down the provisions for drawing up of the annual and multi-annual State budget – Legge di stabilità 2013 (hereinafter "Italian Law no. 228/12"),[17] throughout paragraphs 491 to 500.

The Italian FTT levies three different transactions: (1) transfer of ownership of shares and other participating financial instruments referred to in Article 2346(6) of the Italian Civil Code (paragraph 491); (2) regarding some derivative financial instruments (paragraph 492); and (3) specific HFT transactions on financial instruments provided for in paragraphs 491 and 492 (paragraph 495). The legal regime of the Italian FTT was supplemented by the Decree of Minister of Economy and Finance of 21 February 2013 (hereinafter "Italian Decree of 21 February 2013")[18] and its explicatory memorandum. Article 21, paragraphs 2, 3 and 4 of this Decree provides that the liability for transactions related to financial instruments mentioned in paragraph 491 came into effect on 1 March 2013, while for transactions on financial derivates and HFT transactions this date was 1 July 2013.

According to paragraph 11 of the request for a preliminary ruling from the Regional Tax Court of Lombardy (Commissione Tributaria Regionale per la Lombardia) in the Case C-565/18, Société Générale,[19] the main goal of the Italian FTT is "ensuring that persons who carry out transactions in financial instruments in the relevant markets and who have a link to the territory of the Italian State contribute to public expenditure."

As mentioned above, the Spanish lawmaker has followed, as a model, the taxation of some acquisitions of shares and securities representing capital of a company for valuable consideration. However, and taking into account the purpose of this paper, the author considers it appropriate to also analyze, in summary form, the other modalities that are currently applied in France and Italy.

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16 French Official Gazette of 30 December 2018, as amended.

17 Italian Official Gazette of 29 December 2012, ordinary supplement, as amended.

18 Italian Official Gazette of 28 February 2013, as amended.

19 CJEU Judgement of 30 April 2020, Société Générale S.A. v Agenzia delle Entrate – Direzione Regionale Lombardia Ufficio Contenzioso, Case C-565/18, ECLI:EU:C:2020:318.

2.1.1. France

Regarding the French FTT, it must be reminded that the tax on certain sovereign bond CDSs is not currently in force, although some HFT transactions[20] are levied. Nevertheless, the following requirements must be met with regard to transactions:[21] (1) they must be carried out by a company which operates in France[22] and is a taxpayer; (2) they must affect equity securities as defined under Article L. 212(1) A of the French Monetary and Financial Code (hereinafter French MFC); (3) they must be executed on the company's own account; (4) a computer algorithm determines whether to issue, modify or cancel orders and determines price and quantity parameters; and (5) orders for a given security produced by the algorithm are issued, modified or cancelled according to a time period which may not exceed half a second.

The HFT tax is set at 0.01 % of the amount of orders cancelled or modified over a percentage of the orders issued on one trading day (80%),[23] excluding exempt operations.[24]

In practice, the only modality that, in general terms, has been efficient in achieving the above-mentioned goals is the one on the acquisition of capital shares and similar securities for consideration, as will be apparent

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[20] It should be remarked that, under Article 4(1)(40) of Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/E (hereinafter Directive 2014/65/EU, O.J.E.C. L173, 12 June 2014), there is a legal definition of the term "high-frequency algorithmic trading technique" which means "an algorithmic trading technique characterised by: (a) infrastructure intended to minimise network and other types of latencies, including at least one of the following facilities for algorithmic order entry: co-location, proximity hosting or high-speed direct electronic access; (b) system-determination of order initiation, generation, routing or execution without human intervention for individual trades or orders; and (c) high message intraday rates which constitute orders, quotes or cancellations".

[21] Juan Benito Gallego López, "El Impuesto francés sobre las transacciones financieras como modelo del proyectado impuesto español: un análisis crítico," *Documentos de Trabajo-Instituto de Estudios Fiscales*, no. 4 (2020): 152–3, https://www.ief.es/docs/destacados/publicaciones/documentos_trabajo/2020_05.pdf.

[22] In the sense of Article 209(I) of the CGI. This circumstance is considered to occur when the economic activities are usually conducted in France (either as an autonomous establishment or through a representative who is not independent) or when a full business cycle is completed there.

[23] Article 58(S) (II) of the Annex III of the CGI.

[24] Market-making activities are exempt according to Article 235 ter ZD (III)(3º), of the CGI.

later. The revenue regarding HFT transaction tax has been almost nil and some reasons for this could be the high level of the exemption threshold (80%), and the relocation of the operating companies abroad of France.[25] Nevertheless, its main goal is to avoid certain highly speculative transactions, and the amount of tax revenue may not be the best parameter to measure tax efficiency. Despite the difficulty in finding several conclusive studies on this topic,[26] it is possible to note a reduction in the trading volume achieved by HFT firms after the implementation of the French FTT.[27]

2.1.2. Italy

In the case of Italy, there are another two modalities of financial transactions subject to taxation. On the one hand, these are transactions involving derivative financial instruments provided for in Article 1(3) of Legislative Decree no. 58 of 24 February 1998, concerning financial intermediation.[28] According to Article 1(492) of the cited Italian Law no. 228/2012, taxation is imposed on: (1) transactions whose underlying instruments are mainly one or more of the financial instruments provided for in paragraph 491, or whose value depends essentially on such instruments; and (2) transactions related to securities[29] allowing the purchase or sale mainly of one or more financial instruments referred to in the precited paragraph 491, or involving a cash payment determined mainly by reference to such instruments (including warrants, hedged warrants and certificates).

Article 1(492) also provides that the accrual of the tax will be independent of the place of conclusion of the transaction and the State of residence of the contracting parties. The tax due is a flat-rate tax, which is determined by reference to the specific type of underlying instruments and the value of the contract, in accordance with Table 3 of the Italian Law

[25] Court des Comptes, "La taxe sur les transactions financiéres et sa gestión," 3.

[26] Antonio Weiss and Laura Kawano, "A Proposal to Tax Financial Transactions," in *Tackling the Tax Code: Efficient and Equitable Ways to Raise Revenue*, eds. Jay Shambau and Ryan Nunnm (Washington: Brooking, 2020), 149–89, https://www.brookings.edu/wp-content/uploads/2020/01/TaxBookforWeb_12320.pdf.

[27] Jean-Edouard Colliard and Peter Hoffmann, "Financial Transaction Taxes, Market Composition, and Liquidity," *ECB Working Paper*, no. 2030 (2017): 5; and Iryna Veryzhenko et al., "The Impact of the French Financial Transaction Tax on HFT Activities and Market Quality," *Economic Modelling* 67 (2017): 314, https://doi.org/10.1016/j.econmod.2017.01.021.

[28] Italian Official Gazette of 26 March 1998, ordinary supplement, as amended.

[29] Provided for in Article 1(1bis)(c) and (d) of aforementioned Legislative Decree no. 58.

no. 228/2011. For transactions which take place on regulated markets or in multilateral trading systems, the same fixed-rate tax is reduced to one fifth of the amount.

On the other hand, under Article 1(495), some transactions carried out in the Italian financial market are subject to the HFT tax in respect of the financial instruments referred to in paragraphs 491 and 492 when certain requirements are fulfilled: (1) they are generated by computer-based algorithms which automatically determine whether to issue, modify or cancel orders, and price and quantity parameters of those transactions; and (2) they are made at intervals of not more than half a second. The tax is applied at a rate of 0.02% of the exchange value of the cancelled or modified orders which in one day of stock market trading exceed the numerical threshold established by Article 13 of the above-mentioned Ministerial Decree of 21 February 2013 (i.e. 60% of total orders in one trading day – excluding exempt operations).

In the author's view, the experience of what has happened in Italy and France, especially in the latter case, may have influenced the specific determination of the tax event of the Spanish FTT, exclusively limited to the acquisition, for consideration, of some shares and securities. The next pages of this paper will examine the differences and similarities between the legal regime of the Spanish tax and the French and Italian taxes.

2.2. Legal Framework of the French and the Italian Taxes on Acquisition of Shares and Securities: Similarities and Differences with the Spanish Tax

2.2.1. Taxation Criteria: The Controversial "Issuance Principle"

Both the French FTT[30] and the Italian FTT[31] follow the so-called "issuance principle" as a taxation criterion, taxing determined acquisition of shares, as well as securities that are representative of such instruments, for consideration, when they are issued by companies resident in those countries. Pursuant to Article 1(2) and Article 2(1) and (2) of the Spanish FTTL, certain transactions on shares – and securities representing them – of Spanish companies are taxed; therefore, the above-mentioned "issuance principle" is established as a taxation criterion as well. According to the Preamble of the

30 Article 235 ter ZD(I) of the CGI.

31 Article 1(492) of the Italian Law no. 228/2012.

Spanish FTTL, this criterion "minimises the risk of relocation of financial intermediaries in comparison with the residence principle."

Without doubt, the application of the "issuance principle" is a widely controversial issue. In the case of Spain, firstly, it should be remarked that the Spanish FTTL does not provide a definition of a "Spanish Company"; nevertheless, Article 8 of the Spanish consolidated text of the Corporate Enterprise Law and approved by Legislative Royal Decree 1/2010 of 2 July (hereinafter "Spanish CTCEL"),[32] links that requirement to the company's legal registration in Spain. Secondly, the "issuance principle" is an oddity in the Spanish legal framework; under Article 11 of Law 58/2003 of 17 December on General Taxation,[33] in the absence of a specific criterion in a concrete tax regulation, the residency criterion shall be applied for personal taxes, while the territorial criteria shall be applied in other kind of levies.[34]

Moreover, the "issuance principle" has also been controversial when taking into account the EU legal framework. From this perspective, it is necessary to highlight the judgment of the Court of Justice of the European Union of 30 April 2020, Société Générale, Case 65/18.[35] In this judgment, the Court has resolved a preliminary ruling requested by the Regional Tax Court of Lombardy on whether the establishment of a financial transaction tax based on the residence of the entity issuing the share, which is the underlying instrument of a financial derivative, but not of the participants and the intermediary in the transaction, could be infringing the EU rules, specifically the prohibition of discrimination and the freedoms of providing services and capital movement established in the Treaty on the Functioning of the European Union[36] (Articles 18, 56 and 63, respectively).

The Court's judgment focuses on Article 63, recognizing that there is equal tax treatment of residents and non-residents in the application of the

[32] Spanish Official Gazette of 3 July 2010, as amended.

[33] Spanish Official Gazette of 18 December 2010, as amended.

[34] Alejandro Menéndez Moreno, "Un <<nasciturus>> esperado, aunque no por todos deseado. A propósito del aspecto espacial de aplicación del Impuesto sobre las Transacciones Financieras," *Quincena Fiscal*, no. 4 (2019): 8–9.

[35] CJEU Judgement of 30 April 2020, Société Générale S.A. v Agenzia delle Entrate – Direzione Regionale Lombardia Ufficio Contenzioso, Case C-565/18, ECLI:EU:C:2020:318.

[36] O.J.E.C. C326, 26 October 2012.

Italian tax and, therefore, no discrimination prohibited by the EU law can be observed, but that the tax collection duties must comply with the proportionality principle.

2.2.2. Tax Event and Accrual

In the three jurisdictions analyzed,[37] the tax event is characterized by the existence of an acquisition, for valuable consideration, of shares[38] and securities related to the capital of companies and admitted to trading on a regulated market[39] (national, European or foreign) and issued by national companies of each country, provided that the company's stock market capitalization value is, at 1 December of the year prior to the acquisition, more than 1 billion euros. Nevertheless, in the case of Italy, the threshold is set at 500 million euros with average market capitalization in November of the year preceding the year in which the transfer of ownership occurs.

The tax event takes place irrespective of: (1) the place of conclusion of the transaction and the State of residence of the contracting parties or intermediaries; (2) the market or venue where transaction is concluded, including OTC transactions.

The objective scope of the levy on shares is similar in the examined jurisdictions (except certain kinds of financial instruments),[40] including both capital securities and other similar instruments (i.e. shares or those

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[37] Articles 235 ter ZD(I) of the CGI, 1(491) of the Italian Law no. 228/2012 and 2(1) of the Spanish FTTL.

[38] Article 2(1) of the Spanish FTTL refers to the acquisition of shares, as defined in article 92 of the aforementioned Spanish CTCEL, that can be represented by titles or book entries. Nevertheless, under Article 6(1) of the Spanish SMISL, tradeable securities can be represented also through distributed ledger technology (e.g. Blockchain) according to Regulation (EU) 2022/858 of the European Parliament and of the Council of 30 May 2022 on a pilot regime for market infrastructures based on distributed ledger technology, and amending Regulations (EU) No 600/2014 and (EU) No 909/2014 and Directive 2014/65/EU (O.J.E.C. L151, 2 June 2022).

[39] Under Article 4(1)(21) of abovementioned Directive 2014/65/EU, a regulated market is "a multilateral system operated and/or managed by a market operator, which brings together or facilitates the bringing together of multiple third-party buying and selling interests in financial instruments – in the system and in accordance with its non-discretionary rules – in a way that results in a contract, in respect of the financial instruments admitted to trading under its rules and/or systems, and which is authorised and functions regularly and in accordance with Title III of this Directive."

[40] Article 235 ter ZD(I) of the CGI refers to some Articles of the French MFC.

securities that grant access to a company's capital or voting rights). As regards shares, they include, among others, both ordinary and preferred shares, certificates of participation in profits,[41] as well as shares with preference for the collection of dividends.

In Spain[42] and France,[43] the acquisitions of derivative financial instruments (e.g., options and futures) or convertible or exchangeable debentures or bonds are not levied, but the physical delivery of the underlying financial instrument (when it is a share or equivalent title) is subject to taxation as it is qualified as an acquisition. This is an important difference with Italy, where those derivative financial contracts are within the scope of the tax. Therefore, in France[44] and Spain,[45] the application of the tax could be avoided by contracting derivative financial instruments on shares with monetary settlement (e.g. contracts for differences – hereinafter "CFDs"). Nevertheless, in France, there has been no noteworthy relocation of investment assets in favor of non-taxable investment, such as CFDs.[46]

Moreover, the acquisition, for consideration, of transferable securities in the form of depositary receipts[47] representing the precited shares and irrespective of the place of establishment of the issuer is also subject to tax, but not the rest of operations that structure this financial instrument (e.g. the certificate issuer's purchase of the shares).

In relation to the meaning of the term "acquisition," in the three countries there must be an effective transfer of the financial instrument's ownership, considered in a broad sense (e.g. a purchase – including in connection with the exercise of an option or a forward purchase under an existing

41 Association Française des Marchés Financiers, *French Financial Transaction Tax. Guidelines* (29 March 2023), 11, accessed April 24, 2024, https://www.amafi.fr/download/pages/iL61u5gDgmVsuH9lZpqjUIF8WLYS5Vf0xGDW7GbA.pdf.

42 Article 2(2)(b) of the Spanish FTTL.

43 Article 235 ter ZD(I)(2º) and (II)(9º) of the CGI.

44 Filip Šramko, "The Impact of Securities Transaction Tax on Market Quality: Evidence from France and Italy," *International Journal of Economic Sciences* 4, no. 3 (2015): 53.

45 Gallego López, "El Impuesto francés sobre las transacciones financieras como modelo del proyectado impuesto español: un análisis crítico," 158.

46 Gunther Capelle-Blancard, "The Taxation of Financial Transactions: An Estimate of Global Tax Renevues," *Documents de Travail du Centre d´Economics de la Sorbone*, no. 09R (2023), 8. https://centredeconomiesorbonne.cnrs.fr/wp-content/uploads/23009R_english.pdf.

47 For example, Article 2(2)(a) of the Spanish FTTL.

forward contract – or a swap),[48] which occurs when the settlement of the operation takes place. Thus, acquisitions of a security that are not materialized by a book entry and subsequent settlement, to the extent that they are preceded or followed by sales of the same security, within the same day and in respect of the same purchaser (i.e. intraday transactions) are not taxed; only the net position of the acquisitions at the end of the day is levied in this case. Consequently, in France, for example, between 60% and 70% of transactions may be exempt from tax.[49]

A FTT on intraday transactions has been a really controversial issue. An important argument for their taxation is their highly speculative purpose and the risk of market manipulation, which could be further increased by the use of new technologies and the development of techniques in the area of artificial intelligence (hereinafter "AI") and machine learning.[50] A key argument against taxation is that this kind of trading makes it possible to carry out a great number of transactions, thus allowing the financial instrument pricing and market optimization.[51]

A clear example of this controversy is France. In this country, Article 62 of Law no. 2016–17 of 29 December 2016 on Finance for 2017,[52] with effect from 1 January 2018, modified Article 235 ter ZD of the CGI, repealed the requirement that there must be a transfer of ownership for the

48 Gallego López, "El Impuesto francés sobre las transacciones financieras como modelo del proyectado impuesto español: un análisis crítico," 158.

49 Capelle-Blancard, "The Taxation of Financial Transactions," 3.

50 Alessio Azzutti, "AI Trading and the Limits of EU Law in Deterring Market Manipulation," *Computer Law and Security Review*, no. 45 (2022): 5 et al., https://doi.org/10.1016/j.clsr.2022.105690. According to Article 3(1) of the European Parliament legislative resolution of 13 March 2024 on the proposal for a regulation of the European Parliament and of the Council on laying down harmonized rules on Artificial Intelligence (Artificial Intelligence Act) and amending certain Union Legislative Acts (COM(2021)0206 – C9-0146/2021 – 2021/0106(COD): "'AI system' means a machine-based system designed to operate with varying levels of autonomy, that may exhibit adaptiveness after deployment and that, for explicit or implicit objectives, infers, from the input it receives, how to generate outputs such as predictions, content, recommendations, or decisions that can influence physical or virtual environments."

51 Ministerio de Hacienda, "Memoria del Análisis del Impacto Normativo del Anteproyecto de Ley del Impuesto sobre las Transacciones Financieras" (2018), 14, accessed February 10, 2024, http://www.hacienda.gob.es/Documentacion/Publico/NormativaDoctrina/Proyectos/Tributarios/MAIN%20APL%20ITF.pdf.

52 French Official Gazette of 30 December 2016, as amended.

taxable event, so that all acquisitions made, and not just the net balance, would be subject to tax. Nevertheless, Article 39 of Law no. 2017–1837 of 30 December 2017 on Finance for 2018[53] has re-established said effective transmission requirement.

Finally, with regard to the tax accrual, neither France not Italy make a specific reference to this moment, but to the moment when the tax is due, which is the first day of the month following the taxable event (France),[54] and the sixteenth day of this following month (Italy).[55] In Spain, the tax accrual takes place when the transaction is settled.[56]

2.2.3. Transactions Out of the Scope of the Tax and Exemptions

The French[57] and Italian[58] legal systems, as well as the Spanish[59] one, establish a series of exemptions, many of which are similar, whose fundamental purpose is to promote the proper functioning of the financial markets in relation to the financial instruments analyzed in this paper. As for those of a coincident nature, they can be systematized into the following groups of acquisitions:

(1) In the primary market (i.e. resulting from the issue of those instruments). This also includes acquisitions made: (a) instrumentally, by underwriters and insurers engaged by issuers or offerors for the purpose of the ultimate distribution of these instruments to final investors; (b) in fulfilment of their obligations as underwriters and, in particular, as insurers, of such transactions, where applicable; and (c) by financial intermediaries in charge of price stabilization in the framework of a stabilization order.[60]

[53] French Official Gazette of 31 December 2017, as amended.

[54] Article 235 ter ZD(IV) of the CGI.

[55] Articles 15 et al. of the Italian Decree of 21 February 2013.

[56] Article 4 of the Spanish FTTL and Article 9 of the Spanish Royal Decree 366/2021.

[57] Article 235 ter ZD(II) of the CGI.

[58] Articles 15 et al. of the Italian Decree of 21 February 2013.

[59] Article 3 of the Spanish FTTL.

[60] Defined in Article 2(1)(k) of Regulation (EU) 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC – hereinafter "Regulation (EU) 596/2014" (O.J.E.C. L173, 12 June 2014).

(2) Resulting from certain transactions made by a central counterparty[61] or central securities depository in the exercise of their respective functions in the field of securities clearing or settlement and registration.[62]

(3) Made in the framework of market-making activities.[63]

(4) Made by financial intermediaries on behalf of the issuer in the exercise of their functions as liquidity providers, whose sole objective is to promote the liquidity of transactions and the regularity of the listing of their shares.[64]

(5) Between entities forming part of the same group and regarding certain corporate restructuring operations (e.g. mergers or divisions) according to the domestic law.

(6) Related to securities financing transactions,[65] as well as title transfer collateral transactions resulting from a title transfer financial collateral arrangement.

Having stated the above, it should be noted that the French, Italian and Spanish rules, respectively, establish specific exemption cases. In this sense, the Spanish FTTL exempts the acquisitions arising from the application of the resolution measures adopted by the Single Resolution Board, or the competent national resolution authorities[66]; the French FTTL exempts the

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61 The central counterparty is located between the two parties to a securities transaction (e.g. a purchase and sale of shares) to limit the risk of their non-compliance. The above entails a novation of the initial contract as a consequence of the intervention of said entity.

62 The purpose of this exemption is to guarantee the functioning of the post-trading securities management entities.

63 These activities provide liquidity to the financial markets throughout the process of buying and selling securities.

64 Under the aforementioned Regulation (EU) 596/2014.

65 As referred to in Article 3(11) of Regulation (EU) 2015/2365 of the European Parliament and of the Council of 25 November 2015 on transparency of securities financing transactions and of reuse and amending Regulation (EU) No 648/2012 (O.J.E.C. L337, 23 December 2015).

66 Under the terms provided for in: (1) Regulation (EU) no. 600/2014 of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards on transparency requirements for trading venues and investment firms in respect of shares, depositary receipts, exchange-traded funds, certificates and other similar financial instruments and on transaction execution obligations in respect of certain shares on a trading venue or by a systematic internaliser – hereinafter Regulation (EU) no. 600/2014 (O.J.E.C. L225, 30 July 2014); and (2) the Spanish Law 11/2015 of 18 June on the recovery and resolution of credit institutions and investment service undertakings (Spanish Official Gazette of 19 June 2015, as amended).

acquisitions of bonds that are convertible or exchangeable into shares (in Spain, they are out of the scope); France and Italy exempt the acquisitions linked to certain employee savings schemes including those related to pension fund.[67]

In the author´s opinion, the absence in the Spanish Law of a specific case of exemption for the acquisitions of shares carried out by pension funds must be highly criticized, as it represents an inconsistency in relation to what is provided for in the regulations of France and Italy, countries that have recognized the adverse effect of the entry into force of a tax of this nature for this type of entities.

2.2.4. Tax Base, Tax Rate and Tax Due

In the three jurisdictions analyzed,[68] there is a general method for calculating the tax base and a few special cases. Generally, the tax base is the price paid for the security during a spot purchase. If no such amount is indicated (e.g. a swap), it is the price of the security in the most relevant market in terms of liquidity[69] at the end of the trading day preceding the day on which the transaction occurs. With regard to special rules, for example in the case of acquisitions linked to the execution of a derivative instrument, that base is the strike price, while in the case of conversion, redemption or exchange of a bond, the tax base is the price established in the bond indenture.

There is another important special tax base scheme for intraday operations[70] (i.e. acquisitions and transfers of the same taxable security, ordered or executed by the same tax person, in respect of the same acquirer and settled on the same day), which is calculated by multiplying the positive difference (resulting from subtracting from the number of securities acquired those transferred on the same day) by the quotient resulting from dividing the sum of the consideration for the said acquisitions by the number of securities acquired.[71]

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67 Article 16(1)(5) of the Italian Decree of 21 February 2013.

68 Article 235 ter ZD(III) of the CGI, Article 4 of the Italian Decree of 21 February 2013 and Article 5 of the Spanish FTTL.

69 These markets shall be determined in accordance with Article 4 of the Commission Delegated Regulation (EU) 2017/587 of 14 July 2016 supplementing above-mentioned Regulation (EU) no. 600/2014.

70 Article 58(Q)(I)(h) of Annex III of the CGI.

71 Excluding exempt operations.

The tax due is calculated by applying a tax rate, which depends on the country, to the tax base. In France, the tax rate is currently 0.3%[72]; in Spain, it is 0.2%.[73] A special comment should be made regarding Italy, where the tax rate is linked to the place where the transaction occurs: 0.1% on transactions effected on regulated markets or in multilateral trading facilities (on-exchange), and 0.2% on OTC transactions.[74]

2.2.5. Persons Liable to Tax and Tax Management

In France, the person or entity liable to tax is the investment service provider regardless of where such provider is established (if it executes bid orders on behalf of third parties or purchases for its own account) or, in the absence of such person, the custodian assumes this role. Nevertheless, there is no legal disposition to transfer the tax due to the final customer.

However, as the French Court of Auditors points out,[75] in practice, service providers have transferred (throughout fees and charges) the economic effect of the levy to investors, so it has not effectively fallen on the financial sector. Having stated the above, it should be noted that due to the difficulties that the existence of taxable persons outside French territory may entail in terms of management, the French legislation has granted a predominant role to the French Central Securities Depository,[76] since, in in many cases, it is in charge of collecting the tax and depositing the corresponding amounts of money in the French Public Treasury.

In the case of Italy, the person liable to tax is the acquirer of the levied shares and securities, but collection is made by the financial providers to the acquirer or directly by the acquirer if there is no financial provider.[77]

Finally, in Spain,[78] the taxpayer is the acquirer. Moreover, the Spanish FTTL identifies other persons liable to tax – using cumbersome terminology: (1) investment service firms or credit institutions making the acquisition on their own shall pay the tax, regardless of where they are

72 Article 235 ter ZD(III) of the CGI.

73 Article 7 of the Spanish FTTL.

74 Article 1(491) of Italian Law nº 228/2012 and Article 6 of the Italian Decree of 21 February 2013.

75 Court des Comptes, "La taxe sur les transactions financiéres et sa gestion," 2–3.

76 In France, this role is played by Euroclear France, accessed April 30, 2023, https://www.euroclear.com/services/en/provider-homepage/euroclear-france.html.

77 Articles 1(491) of the Italian Law nº 228/2012 and Article 19 of the Italian Decree of 21 February 2013.

78 Article 6 of the Spanish FTTL.

established if acting for their own account; (2) if the latter is not the case, there are some persons that shall be taxable as substitutes for the taxpayer, depending on the transaction made (e.g. in the event that the acquisition is made in a trading venue, the taxable person shall be the member of the market that executes it); and finally (3) the acquirer who has communicated erroneous or inaccurate information to the above-mentioned other liable persons in order to enjoy an undue exemption or a lower taxable base shall be jointly and severally liable for the tax debt.

As in France, the Spanish central counterparty located in this territory[79] plays a very important role in the tax collection procedure, since taxpayers provide said central counterparty with all the relevant information for the self-assessment, as well as pay the resulting amount, either directly to it or through an entity participating in it. Subsequently, the aforementioned central counterparty will present the self-assessment and pay the amount of tax due that corresponds to each taxable person, acting in the name and on behalf of the latter. The procedure for the presentation and payment of self-assessments may be extended to other central securities depositories established in other Member States, or in third states that are recognized as providing services in the EU, under collaboration agreements signed with a central securities depository established in Spanish territory. The settlement period will be the calendar month.

3. Goals, Achievements and Effects

As stated above, one of the main goals of the FTT is to become a new means of obtaining tax revenue. In France, in the first two years of its entry into force (2012 and 2013), there were substantial differences between the collection initially planned (537 and 1,600 million euros, respectively) and actually obtained (199,05 and 765,99 million euros, respectively).[80] In 2023, tax revenue has reached a volume of 1,077 million euros, very close to the forecast amount for this year, which was 1,100 million euros.[81] In the case of

[79] Namely Iberclear, accessed April 30, 2024, https://www.iberclear.es/esp/.

[80] Gallego López, "El Impuesto francés sobre las transacciones financieras como modelo del proyectado impuesto español: un análisis crítico," 165.

[81] Service de la fonction financière et comptable de l'Etat, "Situation Mensuelle de l'Etat. Décembre 2023 Définitive" (2023), 11, accessed March 15, 2024, https://www.economie.gouv.fr/files/files/directions_services/dgfip/SME/sme_2024-02.pdf?v=1712318878.

Italy, in 2023, and according to the Ministry for the Economy and Finance (Ministero Dell'Economia e Delle Finanze), there is no specific information in the last published Bolletino delle Entrante Tributario,[82] which should mean that the tax revenue is not significant. In Spain, on the other hand, the tax revenue forecast was initially overvalued in the Memorandum on the Regulatory Impact Analysis of the Spanish FTT draft bill,[83] with an amount of 850 million euros; subsequently, the Spanish Independent Authority for Fiscal Responsibility (Autoridad Independiente de Responsabilidad Fiscal)[84] estimated a yearly collection range with a maximum of 850 million euros and a minimum of 420 million euros. Finally, in 2023, the real figure has been only 58 million euros.[85]

In general terms and according to the above-mentioned data, the author´s view is that the establishment of the FFT, as a new source of tax revenue in the jurisdictions analyzed, should be currently qualified as unsuccessful, excluding France. In this last country, another of the tax goals is curbing the most speculative transactions (i.e. certain HFT transactions); nevertheless, as explained above, the tax collection of HFT transactions has been almost nil, probably due to the high threshold (cancelled or modified orders must be higher than 80% of all trading orders) and the possibility to move levied entities abroad of France, although the amount of tax revenue should not be the only item to measure the effectiveness of this levy and it can be appreciate a reduction of HFT trade.

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82 Ministero Dell'Economia e Delle Finanze, "Bolletino delle Entrante Tributario 2024. Genaro 2024" (2024), accessed March 15, 2024, https://www.finanze.gov.it/export/sites/finanze/.galleries/Documenti/entrate_tributarie_2024/Bollettino-entrate-Gennaio2024.pdf.

83 Ministerio de Hacienda, "Memoria del Análisis del Impacto Normativo del Anteproyecto de Ley del Impuesto sobre las Transacciones Financieras" (2018), 10, accessed March 16, 2024, http://www.hacienda.gob.es/Documentacion/Publico/NormativaDoctrina/Proyectos/Tributarios/MAIN%20APL%20ITF.pdf.

84 Autoridad Independiente de Responsabilidad Fiscal, "Informe sobre las Líneas Fundamentales de los Presupuestos de las Administraciones Públicas 2019. Informe 45/18" (2018), 10, accessed March 16, 2024, https://www.airef.es/es/centro-documental/informes/informe-sobre-las-lineas-fundamentales-de-los-presupuestos-de-las-administraciones-publicas-2019/.

85 Intervención General de la Administración del Estado, "Principales indicadores de la actividad económica y financiera del Estado. Febrero 2024" (2024), 9, accessed March 17, 2024, https://www.igae.pap.hacienda.gob.es/sitios/igae/es-ES/Contabilidad/ContabilidadNacional/Publicaciones/Documents/Ind-2024/2024_02.pdf.

A key argument against the FTT is that it could increase transaction costs and, therefore, reduce shares trading and affect market liquidity. In the academia, there are conflict positions regarding this economic issue: one of them considers that this levy has a significant negative impact on the markets,[86] while the other estimates that there are no important consequences for them.[87] In Spain, a recent technical research conducted by the Spanish Securities Market Commission (Comisión Nacional del Mercado de Valores) concluded that shares trading has decreased after the introduction of the tax in this country, and its design may have reduced the incentives for some long-term investors to participate, since the tax base is calculated on the basis of net intraday acquisitions. Regarding illiquidity, this factor has increased only in a short time period (40 sessions), with no observed effects in the medium and long term.[88]

4. Challenges

In the author's view, there are two main challenges that a FTT in the EU should face. One of them relates to the current national levies and the taxation of HFT (specially used for intraday transaction) in a fair way, which is an area in constant evolution due to the increasing use of AI and machine learning in the financial sector. And the other one is the establishment of a common EU financial tax and what its legal framework should look like.

Regarding the first challenge, technological development has provided benefits to stakeholders, such as wider participation in markets, increased liquidity, narrower spreads, reduced short term volatility and the means to obtain better execution of orders for clients. Nevertheless, there are

86 Regarding this, see relevant literature on transaction cost in Filipo Luigi Giambrone, "Possibilities of the Introduction of a Financial Transaction Tax in Germany: Comparison and Evaluation on the Basis of the Italian and French Transaction Tax With Regard of the EU Taxation Principles," *Journal of Accounting and Finance* 23, no. 5 (2023): 5–6, https://doi.org/10.33423/jaf.v23i5.6562.

87 Capelle-Blancard, "The Taxation of Financial Transactions," 15; and Capelle-Blancard, "The Financial Transaction Tax: A Really Good Idea," *AMF-Scientific Advisory Board Review* (2017): 3, https://www.amf-france.org/sites/institutionnel/files/2020-02/201710_etude_ttf_va.pdf.

88 Ramiro Losada and Albert Martínez Pastor, "Analysis of the Implementation of the Spanish Financial Transaction Tax in Equity Markets," *CNMV Working Paper*, no. 83 (2023): 3, http://dx.doi.org/10.2139/ssrn.4430801.

important risks linked to the use of this kind of technology in the financial sector: (1) the issuance of multiple duplicate or erroneous orders (or other anomalies in the issuance or execution of said orders), which may cause serious disruption to investors; (2) trading systems can react in an exacerbated manner to certain events or situations that affect the market, extremely increasing volatility and thereby causing very significant damage; and (3) market manipulation.

In the author's view, the French and Italian HFT taxes seek to avoid those negatives effects, and in France a reduction of transactions made by localized HFT entities could be appreciated as indicated above. Nevertheless, and in order to avoid them, some rules have been passed at the EU level, but not in the tax field.[89] In first place, it is the above-mentioned Directive/65/EU 2014; among the main measures adopted by this directive, the author would like to highlight that trading venues must have control mechanisms over activities that can be classified as HFT. In addition, they must establish systems that guarantee that this kind of negotiation cannot generate (or contribute to) anomalies in the contracting conditions by approving measures that allow, for example, limiting the proportion of orders issued and not executed. Finally, fee and charge structures should not create incentives that disrupt trading conditions or encourage market abuse practices. In second place, it is the aforementioned Regulation (EU) no. 596/2014; in Article 12(2)(c), it qualifies as conduct that constitutes market manipulation (and therefore is sanctionable), the formulation of orders, their modification or cancellation through the high frequency strategy when: (1) false signals are transmitted to the markets; or (2) an abnormal or artificial price is set for financial instruments, with said conduct producing some negative effects (e.g. exacerbating a buying or selling tendency). In the third place, it is Directive 2014/57/EU of the European Parliament and of the Council of 16 April 2014 on criminal sanctions for market abuse (market abuse directive);[90] according to its Article 5(1):

[89] Juan Benito Gallego López, "Aspectos tributarios de las negociaciones algorítmicas de alta frecuencia (*high-frequency algorithmic trading*) en los impuestos que gravan las transacciones financieras: un estudio de Derecho comparado," in *Retos del Derecho Financiero y Tributario ante los desafíos de la economía digital y la inteligencia artificial*, dir. Amparo Navarro Faure (Valencia: Tirant lo Blanch, 2021), 490.

[90] O.J.E.C. L173, 12 June 2014.

"States shall take the necessary measures to ensure that market manipulation as referred to in paragraph 2[91] constitutes a criminal offence at least in serious cases and when committed intentionally."

In the author's view, a HFT tax following the current French and Italian model is controversial in the light of the ability-to-pay principle established in the constitutional texts,[92] since a tax event based only on the number of modified and/or cancelled orders exceeding a certain threshold of the total amount of orders bears no relation to that principle. Moreover, and as explained above, the regime of the HFT tax is certainly complex and difficult to apply. Regarding the results obtained, the tax revenue is irrelevant, but, as explained above, a reduction of HFT trading could be appreciated in France.

In any case, and as indicated in previous pages, there are various market regulation bodies in the EU that have established concrete and specific provisions with the purpose of correcting and limiting certain negative practices linked to HFT transactions that can be applied at the EU level, although some of them should be updated taking into account the continuous technological development.

The other challenge is the implementation of the idea of a common FTT at the EU level, repealing domestic taxes in force, and how this EU tax should be implemented. In this sense, according to the Commision's view:[93] (1) this common tax could be used as a new source of funds for the EU budget; (2) the latter proposal, still under discussion, is similar to the French and Spanish FTTs (i.e. a stamp duty that would apply only to purchases of shares issued by domestic listed companies with a market capitalization higher than 1 billion euros and with a common tax rate); (3) the revenues to the EU budget would likely be more limited than those estimated in the above-mentioned 2011 and 2013 FTT Proposals; and (4) there would be a system of tax collection through financial intermediaries and allocated to the relevant Member States. Nevertheless, there is little expectation that any proposal would be agreed in the short term.

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91 Among others, gives false or misleading signals to the market participants.

92 For example, in Article 31(1) of the Spanish Constitution (Spanish Official Gazette of 28 December 1978, as amended).

93 European Commission, "Commission Staff Working Document Accompanying the Document Amended Proposal for a Council Decision Amending Decision (EU, Euratom) 2020/2053 on the System of Own Resources of the European Union," SWD/2023/331 (2023), 20–2.

5. Final Remarks

The taxation of financial transactions is a very controversial topic in the EU. A proposal for a common tax, with a very wide subject matter and scope (as in the case of the 2011 FTT Proposal) has been rejected.

Meanwhile, some Member States have decided to enact their own domestic taxes on this issue. Regarding the three jurisdictions analyzed in this paper, Italy has the widest scope, as it taxes specific transactions on shares, derivatives and HFT transactions, while France taxes shares and HFT transactions, and Spain only shares. Essentially, the goals of the levies are to attract new public funding sources and, in the case of France or Italy, curb short-term speculative transactions linked to HFT. The achievement of these goals could be described in general terms, as unsatisfactory.

In the author's opinion, a special reflection should be encouraged on some of those speculative transactions. Firstly, intraday transactions enjoy a special and more beneficial tax treatment and the net balance of shares at the end of the trading day is only levied due to the requirement of ownership transfer. In this sense, it is very important to obtain reliable information on these kinds of transactions, and the central security depositaries could play a very important role in this, given that they centralize information about the balance of shares acquired and sold at the end of the trading day.[94] Moreover, the number of transactions could be increased by the use of distributed ledger technology in the financial market (e.g. Blockchain) and it would be fundamental to establish measures to obtain information of this higher volume of operations for an adequate tax collection.

Secondly, according to the author, the relevance of HFT trading is going to be greatly increased by the development of AI and machine learning in short and medium term on financial markets.[95] France and Italy have implemented HFT taxes in order to avoid certain transactions that could affect the proper functioning of the financial market; the tax revenue has been almost nil, but the efficiency of this kind of taxes should be measured by the reduction of negative transactions; according to some empirical

[94] Capelle-Blancard, "The Taxation of Financial Transactions," 12.

[95] Mohammad El Hajj and Jamil Hammoud, "Unveiling the Influence of Artificial Intelligence and Machine Learning on Financial Markets: A Comprehensive Analysis of AI Applications in Trading, Risk Management, and Financial Operations," *Journal of Risk and Financial Management* 16, no. 45 (2022): 1–16, https://doi.org/10.3390/jrfm16100434.

studies, a reduction of transactions carried out by HFT entities could be appreciated in France. Nevertheless, these levies could be controversial according to the ability-to-pay constitutional principle, as their tax event, based only on the amount of modified and/or cancelled orders exceeding a certain threshold of the total amount of orders, has no link to this principle. Moreover, there are other legal bodies in the EU that can be used to avoid such transactions, but they should be regularly updated taking into account the continuous technological development.

Finally, the proposal for implementing a common FTT in the EU as a budget funding source, but only as a stamp duty, is on the table, but it seems that it will not be implemented in the short term.

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Tax Challenges Arising from Digitalization: Evaluating the Taxation Models Proposed by the European Commission and the OECD

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Abstract: The world has entered a period of deep transition with rapid and phenomenal development of innovations. The rise of the digital economy has dramatically changed the global business environment, creating new challenges for the tax system. Newspapers and magazines are being replaced by the Internet, and trade in material goods – by digital services. The digital economy eliminates the barriers of time, space and distance. The server where the transaction is processed, the location from which the goods or services are supplied and the place of supply of such goods or services are in different jurisdictions, therefore, the question "Where should the transaction be taxed?" is raised. Meanwhile, the digital economy opens up unprecedented opportunities to avoid taxes with the international tax rules which are still "stuck" in 20th-century business concepts, because the companies operating in the digital space do not need factories, stores or other permanent residences to develop their activities. This article aims to evaluate the efforts of the European Union and international standard-setting entities to find a solution for fair taxation of the digital economy. The first part of the article delves into the concept of the digital economy and its essential features with a special emphasis on the role of the digital service user which is unique and more

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complex than the role usually played by the customer. This part also analyses the differences between digital and traditional business. The second part of the study emphasizes the reasons that will lead to the necessity of taxation of the digital economy, discusses the digital services tax applied in certain countries of the European Union and highlights the weakness of the concept of digital establishment in double taxation agreements concluded by the countries. The final part explores the proposals submitted by the European Commission regarding the introduction of a common consolidated corporate tax base and the inclusion of the concept of virtual permanent establishment in the tax system in the context of the digital economy taxation model proposed by international organizations.

1. Introduction

Today, we are living through the last known revolution in history, also known as the 4th Industrial Revolution, which is "blurring" the boundaries between physical and digital space. The main pillar of the 4th Industrial Revolution is digitalization, which is characterized by the rapid, deep and widespread penetration of digital technologies into everyday life. In the context of this revolution, the traditional concept of a "one-size-fits-all" economy is being replaced by that of the new economy, also known as the "Digital Economy." The liberal concept of the digital economy is considered to have disrupted the previously rigidly defined traditional business model. The evolutionary processes of modern society are based on digital systems that create a wide range of opportunities. This is giving rise to new digital businesses that do not resemble the traditional business model since they lack physical characteristics, which allows them to operate on a much larger scale, at lower costs and with easier access to consumers.

However, technological progress poses many challenges, especially in the area of tax regulation. In terms of the specifics of corporate tax, the old and universally accepted corporate tax standards are designed for the traditional "bricks and mortar" business model, which means that a company has to have a physical presence in a country in order to be taxed there. The tax rules developed in the early 20th century for traditional physical businesses have begun to mismatch the location of profit taxation and value

creation when applied to new business models. In addition, the characteristics of digitalized businesses, such as the ability to transfer profits from one jurisdiction to another at the touch of a button, or the fact that these business models are the result of consumers being "employed" to interact with each other in the creation of value for these businesses, give them an advantage over traditional business models, leading to the emergence of unfair competition in the global market. It is also important to note that a number of indicators suggest that the tax practices of some multinational digitalized companies have become more aggressive over time, raising serious compliance and fairness issues.

Although matters of direct taxation of corporate income tax are within the competence of national law, it should be noted that, for example, there are currently no specific rules on the taxation of digital businesses in Lithuania. Meanwhile, there is a consensus at both the international and European Union (EU) level that the adoption of a "perfect" international solution will be a long process with no guaranteed success.[1] At the EU level, there has been a proposal to introduce a Common Consolidated Corporate Tax Base ("CCCTB") in the context of digitalization, a proposal by the European Commission on March 21, 2018 to reform the corporate tax rules so that profits are taxed where a company's significant digital activities are located, and a proposal to introduce a temporary tax on income from digital services. The G20 and the Organisation for Economic Co-operation and Development (OECD) have presented a two-pillar framework. In terms of the most recent legislation, it should be noted that, as part of the implementation of one of the pillars, Directive (EU) 2022/2523 on ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups in the Union was adopted on December 14, 2022. However, it is acknowledged that finding a solution at the global level to make the most of globalization through high-quality governance and international rules is a challenging task, especially as taxes are rarely universally acceptable, much less newly introduced ones. Therefore, in view of the widespread digitalization of business in practice and the speed of change in this area, it is appropriate to analyze the proposed model for

[1] Mateusz Kaźmierczak, "EU Proposal on Digital Service Tax in View of EU State Aid Law," *Financial Law Review* 25, no. 1 (2022): 97.

regulating the taxation of digital business without waiting for legal regulation. As such regulation is not yet in place, this topic is of interest not only from an academic point of view but also from a practical one.

The authors acknowledge that digital taxation issues also extend to indirect taxation, but due to the limitation of the object of this publication, this field of taxation will not be addressed.

2. The Reasons behind the Need to Tax the Digital Economy

The concept of the digital economy was first articulated by Don Tapscott, who wrote in a 1995 seminal paper that "the Internet and the World Wide Web are enabling a new economy based on human intelligence."[2] It is notable that today there is still no succinct definition of the digital economy, as various economic activities are usually defined.

In a literal discussion of the term digital economy, the English word "digital" in electronics and computing means "encoded in numbers."[3] The terms "digitization" and "digital transformation" are interpreted as processes that operate through digital technologies and have an impact on production processes, the functioning of financial markets, changing economic development patterns and society as a whole.[4] More specifically, from an economic perspective, "digitization" or "digital transformation" is defined as the changes taking place in any part of society through the application of digital technologies. Looking at digital transformation specifically from a business perspective, it is also recognized as a process whereby an increased use of digital technologies in significant processes leads to superior business performance.[5] As stated in the Lithuanian Innovation

[2] Łukasz Dawid Dąbrowski and Magdalena Suska, *The European Union Digital Single Market: Europe's Digital Transformation* (London, New York: Routledge, 2022), 1, https://ebookcentral-proquest-com.ezproxy.vdu.lt:2443/lib/vmulib-ebooks/reader.action?docID=6894571.

[3] Rimvydas Laužikas, "Digital or Electronic?," *Knygotyra* 51 (2008): 278.

[4] Dominik Matt et al., "Industrial Digitisation. A Systematic Literature Review and Research Agenda," *European Management Journal* 41, no. 2–4 (2022): 47–78, https://doi.org/10.1016/j.emj.2022.01.001.

[5] Dave Chaffey, David Edmundson-Bird, and Tanya Hemphill, *Digital Business and E-commerce Management* (UK: Pearson, 2019), 23, accessed September 10, 2023, https://books.google.pl/books?id=oYufDwAAQBAJ&printsec=frontcover&hl=pl&source=gbs_ge_summary_r&cad=0#v=onepage&q&f=false.

Ecosystem Review, the use of digital technologies in business is one of the preconditions for developing an innovative business sector.[6]

Given the complexity of the functioning of digitally enabled businesses, however, according to the latest statistics provided by the European Commission, there is a clear advantage of the digital business model compared to the traditional one:

- Digital businesses are growing faster. The largest digitalized companies have an average annual revenue growth of 14%, while the average annual revenue growth of traditional multinational companies ranges between 0.2% and 3%;
- digitized businesses operate with almost no physical presence on the ground. Only 50% of digital multinationals operate abroad compared to 80% of traditional multinationals;
- digital businesses benefit from lower tax rates. On average, traditional businesses pay around 23.2% of tax per year, while digitized businesses pay around 9.5%.[7]

The liberal concept of the digital economy is thus presumed to have disrupted the hitherto rigidly defined traditional business model. Digitally enabled businesses can operate simultaneously in several jurisdictions without a physical presence, however, they are dependent on consumers who contribute to the value creation of the digital business. Nevertheless, these characteristics give digital businesses an advantage in a market that is arguably characterized by high taxes and social and economic inequalities.

As digital services and e-commerce increasingly penetrate the global economy, concerns have been raised about how the tax system will adapt to the rapidly evolving digital economy. As mentioned earlier, there are two types of digital business models – partly digital and exclusively digital – but it should be noted that the former is at least partly suitable for the old tax

6 Ramunė Juozapaitienė, *Overview of the Lithuanian Innovation Ecosystem* (Vilnius: Government Strategic Analysis Centre, 2021), 13, accessed May 3, 2023, https://osp.stat.gov.lt/services-portlet/pub-edition-file?id=36260.

7 European Commission, "Fair Taxation for the Digital Economy," 1, accessed May 8, 2023, https://taxation-customs.ec.europa.eu/system/files/2018-03/factsheet_digital_taxation_21032018_en.pdf.

rules, while the exclusively digital business model cannot be adapted to current tax systems. In particular, a number of studies and data have shown that there is an increased disconnect between the place where a company's actual activities are carried out and the place where profits are reported for tax purposes. Genuine business activity is usually identified through such elements as sales, labor, wages and fixed assets.[8] However, the activities of a digital business can be transferred to another jurisdiction at the click of a button. It is often argued that this is also a way of avoiding taxation where taxes are higher. While it has been established that profits are taxed where value is created under the current rules, digitized businesses have started to use schemes to artificially shift profits to economically weak countries with low tax rates or with no tax by exploiting loopholes and inconsistencies in tax rules. This can happen even when legitimate profit-shifting strategies are used.[9] For example, a digitized company sets up its headquarters and digital servers in countries such as Ireland or the Netherlands, where corporations are subject to low tax rates, using the headquarters to provide digital services to the rest of Europe.[10] Google, for example, is just one example of the many digitized companies that have taken advantage of this tax system. For many years, Google has, from its headquarters in Ireland, awarded advertising contracts across Europe so that profits from the contracts were taxed only in Ireland and not in the countries where the ads were placed.[11]

Another important aspect is that taxing a digitalized company does not account for the contribution of consumers to the generation of profits. As mentioned above, the digital economy is dependent on the crucial role of the consumer, but while this is creating increasingly more value for multinational groups of companies operating in the digital economy, it is difficult to measure the benefits that consumers bring. According to

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8 OECD, *Addressing Base Erosion and Profit Shifting* (Paris: OECD Publishing, 2013), 20, http://dx.doi.org/10.1787/9789264192744-en.

9 Andrea Darmanin and Kirsten Debono Huskinson, "The Countdown to Pillar One Begins," *ITR*, accessed November 7, 2023, https://www.internationaltaxreview.com/article/2a6aaf-in5m44msd672q68/the-countdown-to-pillar-one-begins.

10 Laurel Wamsley, "France Approves Tax On Big Tech, And U.S. Threatens To Retaliate," *American University Radio*, accessed October 25, 2023, https://perma.cc/H42P-44EZ.

11 Romain Dillet, "Google to Pay $549 Million Fine and $510 Million in Back Taxes in France," *Tech Crunch*, accessed October 25, 2023, https://perma.cc/B24J-AVH7.

the European Commission, new profit attribution methods are needed to measure and define the contribution of consumers to value creation in a company, which would better capture value creation. Current corporate tax rules provide that assessing how much of a company's profits should be attributed to a particular country mainly takes into account the physical location in that country, without reflecting the value created by the user in that jurisdiction.[12] This value is used for targeted advertising and is subsequently used to generate profits, but these profits are not taxed in the country of the user but in the country where, for example, the advertising algorithms were developed. It is therefore argued that, in the context of rapidly changing business models, it is necessary to assess the contribution of data and user involvement to value creation, while at the same time assessing the extent to which data and user involvement contribute to value creation.

2.1. Fiscal Jurisdiction over Digital Activities

Tax authorities are currently unsure how to tax income earned on the Internet because the Internet does not easily fit into the existing general international tax framework.[13] Since it was noticed that the determination of fiscal jurisdiction by the residence and source location criteria was no longer as effective in today's economy as compared to traditional business taxation, a new criterion for determining fiscal jurisdiction based on the place of destination was considered as early as the beginning of the 21st century.[14] Proponents of this new criterion argue that in a global world economy where capital moves freely and new economic conditions prevail, both residence and source taxes distort international trade and the movement of capital and business,[15] and that the purpose of establishing a fiscal jurisdiction based on the destination criterion is to reduce or eliminate profit shifting

12 European Commission proposal for a directive laying down rules on the taxation of significant digital activities of undertakings, Brussels, 21 March 2018, 2018/0072 (CNS), 2.

13 Barrett Schaefer, "International Taxation of Electronic Commerce Income: A Proposal to Utilize Software Agents for Source-Based Taxation," *Santa Clara Computer and High-Technology Law Journal* 16, no. 1 (2000): 139, accessed May 10, 2023, https://digitalcommons.law.scu.edu/cgi/viewcontent.cgi?article=1256&context=chtlj.

14 Michael P. Devereux and Rita de la Feria, "Designing and Implementing a Destination-Based Corporate Tax," *Oxford University Centre for Business Taxation WP* 17, no. 7 (2014): 8.

15 Ibid., 2.

and tax competition.[16] The OECD proposes that fiscal jurisdiction could be implemented based on a significant economic nexus. According to this principle, jurisdiction to tax should be allocated according to where the real economic interests of taxpayers lie. Accordingly, natural and legal persons are deemed to have an economic interest where they earn or receive income or where they carry out economic activities.[17]

In order to answer the question of whether States would have jurisdiction to tax businesses based on this criterion, it is argued that the application of this criterion would create a link between what is being taxed and the State imposing the tax. If sales are conducted in a particular State, that State is evidently the source of the revenue: the profits are derived from the sales, and without the sales, there would be no taxable income.

In considering the application of this criterion, the benefit theory mentioned before is also discussed, and it is believed that it could also be applied to this criterion. Similarly to the place-of-source criterion, the benefit theory holds that States should have the right to tax income that is sourced within their territory, as this is the "place of generation," a right that derives from the principle of territoriality enshrined in international law. Furthermore, States should have the right to tax income that originates in their territory, since the States where consumers reside provide them with services that complement the consumption carried out by their population. This creates a win-win situation whereby the State, through its policy of raising wages and contributing to the improvement and development of Internet connectivity, contributes, albeit indirectly, to the promotion of consumption among its population by creating the conditions for the online purchase of goods and services, and, consequently, the businesses receive revenue from these consumers and should therefore pay a proportion of the corporate tax.

In a global economy, it is argued that both residence and source taxation should be abandoned in favor of a new factor linking tax jurisdictions:

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[16] Shafik Hebous and Alexander Klemm, "Destination-Based Taxation: A Promising but Risky Destination," in *Corporate Income Taxes Under Pressure: Why Reform Is Needed and How It Could Be Designed*, ed. Alexander D. Klemm (Washington, DC: International Monetary Fund, 2021), 265.

[17] Elena Neshovska Kjoseva, "Taxation in Era of Globalization and Digitalization: Issues and Challenges on National Tax Sovereignty," *Iustinianus Primus Law Review* (2021): 6.

the location of consumers, which is less mobile than business activity and more difficult to manipulate for tax purposes. It is argued that the State where the consumer of the goods or services provided by the business entity is located would have jurisdiction to tax it for essentially three reasons: (i) sales are the ultimate source of profits and without sales – there would be no taxable income; (ii) it is a "source of income" State and therefore its right to tax would arise even under the principle of territoriality established by international law; and (iii) as a State of residence of the consumers, it is a State that provides services that are complementary to the consumers' consumption (and therefore provides services that indirectly contribute to the production of income).

2.2. The Lithuanian Concept of a Permanent Establishment in the Context of Digitization

The legal concept of a permanent establishment sets out the necessary criteria for the link that an economic or commercial activity has with a particular State to be considered sufficient to give rise to a tax liability in that State.[18] However, as Irmantas Rotomskis rightly points out, the possibility of taking business online in recent decades has raised new obstacles to applying the concept of permanent establishment. As has already been shown, in the digital economy, thanks to advances in information technology, activities are carried out via the Internet. Consequently, in the digital economy, a remote link is created between the State and the taxable profits, but this contradicts the concept of a physical permanent establishment, because, in the absence of a physical link, the State in which remote digital activity is carried out has no legal basis to claim taxing rights. It is important to emphasize that the various aspects of corporation tax are exclusively a matter of national law. This means that it is with the country in whose territory the activity is carried out that lies the full competence to tax businesses established (i.e. tax resident) and domiciled in its territory.[19] The Law on Corporate Income Tax of the Republic of Lithuania states that Lithuania has full competence to tax business entities established and having their

[18] Irmantas Rotomskis, "The Significance of the Head Office Institute in Avoiding Double Taxation in Electronic Commerce," *Jurisprudence* (2004): 135–6.

[19] See footnote 9: "Issues and Challenges in the Taxation of Digital Business," 102.

permanent establishment in its territory – "The taxable profits of Lithuanian units and permanent establishments shall be taxed at a tax rate of 15 per cent."[20] Article 5(1)(2) of this law also states that certain types of income of a foreign entity shall be taxed at a 10% tax rate when the source of income is in the Republic of Lithuania and the income is not derived from that entity's permanent establishments in the Republic of Lithuania.[21] Article 4 of this law contains an exhaustive list of cases in which this tax also applies to foreign companies, but this list does not include income received by a digitized company. It is therefore important to underline that Lithuanian national law does not currently stipulate specific rules on the taxation of digital businesses, as the Lithuanian Corporate Income Tax Law does not address the taxation of digital domiciles.[22]

Accordingly, against this background, the aspects of double taxation in the context of digitalization should also be highlighted, as a permanent establishment is the most important aspect of the institution of double taxation. For example, the Treaty between the Government of the Republic of Lithuania and the Government of the French Republic on the avoidance of double taxation of income and capital and the prevention of fiscal irregularities states that "[t]he profits of an enterprise of a Contracting State shall be subject to tax only in that State if the enterprise does not engage in commercial and economic activities in the other Contracting State through a permanent establishment situated therein."[23] "For the purposes of this Treaty 'permanent establishment' shall mean a fixed place of business through which the whole or part of the commercial and economic activities of an enterprise are carried on."[24] The exhaustive lists in Article 5(2) to (4) of the said treaty define what is included in and excluded from the notion of permanent establishment, but it is noted that under the treaty, the notion of a traditional permanent establishment does not include the head office

[20] Law on Corporate Income Tax of the Republic of Lithuania, State Gazette No. 110–3992 (2001), Article 5(1)(1).

[21] Ibid., Article 5(1)(2).

[22] Vilnius University Faculty of Law Student Scientific Society, *Spring of Legal Science* (Vilnius: Vilnius University Publishing House, 2020), 112.

[23] Treaty between the Government of the Republic of Lithuania and the Government of the French Republic on the avoidance of double taxation of income and capital and the prevention of fiscal irregularities, State Gazette No. 106–2675 (1997), Article 7(1).

[24] Ibid., Article 5(1).

of an undertaking carrying out digital activities. A similar situation can be observed in the other double taxation treaties that Lithuania has concluded with 58 other countries.

Double taxation is often cited as a major obstacle to unrestricted economic progress. It is clear that the current double taxation treaties between countries are not suitable for taxing digital businesses, as these treaties only tax entities with a traditional permanent establishment. It is therefore considered necessary to revise and supplement the existing double taxation treaties once standards for the taxation of the digital economy have been established.

2.3. Digital Service Tax

It is clear that today's rules make it possible for digital businesses to operate without being taxed, generating significant revenues. Despite ongoing negotiations in international law, EU countries, such as Austria, France, Hungary, Italy, Portugal, Poland and Spain, have taken national measures to ensure that all businesses – digital and traditional – pay their fair share of tax, and in view of the real risk that non-taxed digital business profits pose to Member States' tax revenues. In contrast to Lithuania, these countries have introduced in their national legislation a digital services tax, the main objective of which is to ensure the taxation of technology-based multinationals despite their physical absence.

However, when assessing the effectiveness of this digital services tax in taxing the digital economy, it is noted that such unilateral measures by Member States may violate existing tax treaties which provide for the taxation of corporate income without a sufficiently significant physical presence in the country imposing the tax.[25] At the same time, the different rates of this tax, the scope of taxation and the different thresholds for taxing corporate income have given rise to widespread debate, on the grounds that this discriminates against large digitalized companies and is incompatible with the principles of international taxation. For example, following France's introduction of a 3% digital services tax

[25] Katherine E. Karnosh, "The Application of International Tax Treaties to Digital Services Taxes," *Chicago Journal of International Law* 21, no. 2 (2021): 516, accessed May 15, 2023, https://chicagounbound.uchicago.edu/cjil/vol21/iss2/8.

on digital intermediation and advertising services based on consumer data in 2019, the United States of America has launched an investigation into the amount of tax France imposes on US companies. A report by the Office of the United States Trade Representative (the "US Trade Representative") found that France discriminates against major US companies and violates prevailing international tax principles because the taxable income is not linked to physical presence.[26] Meanwhile, the French digital services tax is nicknamed the "GAFA tax," an acronym for the major US companies Google, Apple, Facebook and Amazon.[27] However, this acronym might be misleading, as in France the tax is not only levied on US companies but also other major multinational digitized companies. Although the prospect of retaliation on the part of the US has led France to consider a temporary suspension of the digital services tax to reach a compromise on international digital taxation, the digital services tax is still in force in France today, given that international agreements have not been implemented.

There is no universal agreement regarding digital service tax efficiency. According to a survey, a considerable number of countries have postponed the digital service tax (DST) (for example Belgium, Poland, Hungary, Canada, Czechia, Tunisia, Uganda, Zimbabwe, Brazil, Colombia and Sierra Leone).[28]

> Hungary has had an active DST since July 2017, but the tax rate has been set to 0% since July 2019. Poland, Belgium, Columbia, Brazil and the Czech Republic all proposed a DST, but decided to not adopt it. Tunisia, Uganda, Zimbabwe and Sierra Leone all adopted a DST, but have not implemented it.[29]

In summary, the absence of a proper tax framework for the digital economy is contrary to the legal concept of a permanent establishment and

[26] Congressional Research Service: Informing the legislative debate since 1914, "Section 301 Investigations: Foreign Digital Services Taxes (DSTs)," updated 1 March 2021, 1, accessed May 10, 2024, https://crsreports.congress.gov/product/pdf/IF/IF11564.

[27] "Digital Services Tax in France," Bird & Bird, accessed October 24, 2023, https://www.twobirds.com/en/insights/2019/global/digital-services-tax-in-france.

[28] Sofía Balladares, Mona Barake, and Enea Baselgia, "Digital Service Taxes Kane Borders," June 2023, accessed May 9, 2023, https://www.taxobservatory.eu/www-site/uploads/2023/06/EUTO_Digital-Service-Taxes_June2023.pdf.

[29] Ibid., 28.

creates the conditions for many multinational digitalized corporations to operate without being physically established in the countries from which their profits are derived. At the same time, it encourages the emergence of unfair competition in the market, as digitalized companies that operate across borders and use sophisticated tax avoidance schemes may have a significant advantage over other small or medium-sized enterprises.

3. Evaluation of Proposed Models for Taxing the Digital Economy

Due to the need to create a suitable taxation model, with the establishment of the Code of Conduct group in 1997, the EU began to promote the policy of fair tax competition. In the field of corporate taxation, the most important result achieved at the EU level was the Code of Conduct for Business Taxation, which addresses the issues of tax evasion and avoidance, and competition in taxation within the EU and beyond. The Member States have committed themselves at the political intergovernmental level to monitor potentially harmful tax measures of the EU Member States and to correct those tax measures that could be harmful to the tax bases of the Member States.[30]

Corporate income is generally taxed at the national level, noting that the EU has exclusive competence only in the area of indirect taxes such as VAT.[31] Decisions on taxation with direct taxes, such as corporation tax, are the exclusive prerogative of national law. It should be noted that the EU's Consolidated Treaty establishing the European Community does not explicitly provide for legislative competence in direct taxation. However, a systematic interpretation of Article 115 of this treaty, which states that the EU is authorized to adopt directives for the approximation of the laws, regulations and administrative provisions of the Member States directly affecting the common market, suggests that the EU has the right to intervene in the European regulation of corporate tax and, within the limits of its competence, to address, by various means, the issues relating

30 "Code of Conduct Group (Business Taxation)," Council of the European Union, accessed September 4, 2024, https://www.consilium.europa.eu/en/council-eu/preparatory-bodies/code-conduct-group/.

31 Consolidated Treaty establishing the European Community, State Gazette No 2–2 (2002), Article 93.

to the improvement of the functioning of the EU's internal market and the solution of common problems of Member States.[32]

3.1. Introducing Rules on the Taxation of Significant Digital Activities of Companies

On March 21, 2018, the European Commission published two legislative proposals: a long-term one to reform corporate tax rules to tax profits where a company has a significant digital presence and a short-term one to introduce a temporary tax on income from digital services. Regarding the first, long-term proposal – a general reform of the EU's corporate tax rules on digital activities – the European Commission points out that this proposal would allow Member States to tax profits earned in their territory even if the company has no physical presence there. The proposal recommends extending the concept of permanent establishment for corporate tax purposes in each Member State to include the definition of a significant digital establishment. The proposal seeks to set quantitative thresholds relating to the taxable enterprise's revenue, the number of users and the number of business contracts concluded.

While in this proposal the location of consumers for corporate tax purposes, and not, for example, the origin of the payment, is the key to determining the place of taxation, measuring the number of consumers over a given fiscal period leaves unclear how long consumers should be in the home jurisdiction.[33] It is also clear that the proposal does not take into account the consumer's place of residence. For example, if a consumer has to travel for personal or professional reasons to a particular country, the same consumer may be counted more than once under the proposed criteria. In addition, the same user may access the same website via different platforms, which would presumably further complicate the application of the criteria set by the significant digital presence. It can therefore be understood that the criteria are linked to the presence of a large user base in the jurisdiction, but this does not seem to take into account the differences

[32] See footnote 9: "Issues and Challenges in the Taxation of Digital Business," 108.

[33] Marina Barata, "A Consensus Solution for the Taxation of the Digital Economy," *UNIO – EU Law Journal* 7, no. 1 (2021), 131, accessed May 10, 2023, https://revistas.uminho.pt/index.php/unio/article/view/3576/3631.

in the market between the geography, size of the economy or population of the different EU Member States.

Another important point is that in the preamble to the proposal, the European Commission states that the criteria should apply to different types of business models.[34] However, according to Marina Barata, digital business models are very heterogeneous – some may have a very large consumer base and others a smaller one, but may still have a significant consumer contribution.[35] Thus, the limit on the number of users raises doubts about whether this is actually about the value created by users, as not all users contribute equally to digital business, and different digital models allow for different levels of user involvement.

It is also noted that the preamble to the proposal also adds that it is essential that each of the thresholds for the criteria for a significant digital establishment is sufficiently high to safely exclude small entities where the profits attributable to the digital establishment do not even cover the cost of the tax liability of the permanent establishment, i.e. to ensure the proportionality of the measure in the application of these three alternative thresholds.[36] It seems reasonable to believe that this would only tax large digitalized companies located in developed countries while leaving out small and medium-sized companies located in developing countries. This raises the question of how such regulation would be coped with by start-ups which would not be able to achieve the objectives of this initiative.

4. Conclusions

1. Businesses enabled by advanced information technologies operate simultaneously in several jurisdictions, without a physical presence, and are dependent on consumers who contribute to the value creation of digital business. These characteristics enable activities to be carried out

[34] European Commission Proposal for a Directive laying down rules concerning the taxation of significant digital activities of undertakings, Brussels, 21 March 2018, COM(2018) 147 final 2018/0072 (CNS), https://eur-lex.europa.eu/resource.html?uri=cellar:3d33c84c-327b-11e8-b5fe-01aa75ed71a1.0011.02/DOC_1&format=PDF.

[35] See footnote 33: "A Consensus Solution for the Taxation of the Digital Economy," 130.

[36] See footnote 34: European Commission proposal for a Directive laying down rules on the taxation of significant digital activities of undertakings.

on a much larger scale and over greater distances without a physical presence, which results in digitized businesses growing much faster than the economy as a whole, and in the fact that they tend to pay less tax than other traditional, physically established businesses.

2. The current tax system is based on the legal concept of a permanent establishment – a company has to be physically present in a country to be taxed there – but this does not cover digital business models, because as the economy becomes increasingly digitalized, many multinational companies headquartered in a single country profit from services provided to consumers in other countries. This contradicts the concept of permanent establishment, does not ensure the functioning of double taxation and allows for aggressive tax policies that create an unfair and uncompetitive economic environment.
3. The process of harmonizing corporate income tax in the EU is chaotic. The European Commission's proposal to introduce a Common Consolidated Corporate Tax Base (CCCTB) does not specify the characteristics of digital businesses, and the European Commission's proposals of 21 March 2018 have been particularly criticized for proposing unclear formulas for calculating the contribution generated by users and for setting too high a quantitative target. It is argued that this may lead to qualification issues in distinguishing between digital businesses that fall within the scope of regulation and those which do not and that the quantitative criteria set may be considered arbitrary.

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Cooperative Compliance in Poland: The Question of Equality

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Abstract: An increasing number of tax jurisdictions are implementing the concept of cooperative compliance into their tax systems. It aims to improve tax compliance by building an enhanced relationship between tax authorities and taxpayers. In principle, the programme is aimed at large taxpayers capable of engaging in aggressive tax optimization that is detrimental to state revenue. Dedicating the programme exclusively to large taxpayers may raise doubts about whether it violates the principle of equality before the law. In Poland, the legislation governing the cooperative compliance programme was introduced on July 1, 2020. As in other countries, it was targeted at large taxpayers. The article therefore discusses the question whether the Polish legal regulations on cooperative tax compliance are in line with the constitutional principle of equality.

1. Introduction

Cooperative compliance is a programme that has been implemented for more than 12 years. It began to be introduced into the tax systems in Anglo-Saxon countries' over the first decade of the 21st century. Meanwhile, in most European countries, it began to be adopted in the second decade of the 20th century.[1] The reason for this was that it was promoted by the OECD,

[1] See: Katarzyna Bronżewska and Alicja Majdańska, "Program Współdziałania z Dużymi Podatnikami – polski odpowiednik co-operative compliance. Czy warto?," *Przegląd Prawa Podatkowego*, no. 2 (2019): 45–8; Marta Kluzek, "Bariery implementacji Co-operative Tax Compliance w Polsce," *Ruch Prawniczy, Ekonomiczny i Socjologiczny*, no. 3 (2020): 220–4;

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which issued three reports in the form of recommendations to member countries of the above organization.[2] The objective of the programme is to improve tax compliance by building a stronger relationship between tax authorities and taxpayers. Hence, countries that have cooperative compliance in their systems are changing their approach to relations with taxpayers. A cooperative approach is being introduced where possible, giving taxpayers greater legal certainty in return for tax transparency. It should be noted that, in principle, the cooperative compliance programme is aimed at large taxpayers who, because of their staffing, internal structure, and financial capacity, are more likely to engage in aggressive tax optimization, which is undesirable from the point of view of the fiscal interest of states. The above fact often gives rise to accusations that this group of entities is favored. This is because it is often considered whether the preferential treatment of a certain category of taxpayers does not violate the constitutional principle of equality before the law. Admittedly, one of the OECD reports argues that the principle of cross-compliance does not violate the principle of equality,[3] however, it should be noted that this report is not legally binding. Hence it appears that the decisive factor as to whether the above institution violates the principle of equality will be how a country implements it in its legal system.

This article aims to answer the question whether the Polish legislator, by introducing cooperative compliance into the Polish legal order, violated the constitutional principle of equality. First, the article outlines the problems faced by modern states and the essence of cooperative compliance. Second, the essence of the Polish scheme, which was introduced in mid-2020, is discussed, which is followed by the examination of its compliance with the principle of equality.

Ronald Russo, J.J. Engelmoer, and Mário H. Martini, "Cooperative Compliance in the European Union: An Introduction to the European Trust and Cooperation Approach," *Bulletin for International Taxation*, no. 2 (February 2022): 90–1; Dario Marano, "Le cooperative tax compliance," in *L'evoluzione della fiscalità internazionale le venti „primavere" di Napoli. Atti del XIX Simposio di Fiscalità Internazionale e Comunitaria Springs in Naples*, eds. Clelia Buccico, Stefano Ducceschi, and Salvatore Tramontano (Padova: CEDAM, 2020), 143–8.

[2] OECD, *Study into the Role of Tax Intermediaries* (Paris: OECD Publishing, 2008); OECD, *Co-operative Compliance: A Framework: From Enhanced Relationship to Co-operative Compliance* (Paris: OECD Publishing, 2013); OECD, *Co-operative Tax Compliance: Building Better Tax Control Frameworks* (Paris: OECD Publishing, 2016).

[3] OECD, *Co-operative Compliance*, 45–8.

2. The Essence of Cooperative Compliance

Modern states are placed in an extremely difficult position. In their traditional role, they are obliged to fulfil tasks for their societies. Consequently, they are determined to obtain certain revenues, which nowadays come from taxes, because of the widespread privatization of public assets. In addition to the delivery of the so-called traditional duties, states face new challenges. These arise, on the one hand, from ever-changing social needs and internal problems such as the ever-increasing public debt, or an ageing population, which will give rise to an even greater public expenditure in the near future. On the other hand, states are subject to increasing pressures from the international environment in which they have to operate. One should, for example, mention the implementation of a common immigration policy, which is caused by illegal immigration, or the implementation of the European Union's ambitious plan to go "net zero" CO_2 emissions by 2050. The implementation of such programmes will inevitably increase public expenditure. In addition to that, it should be noted that the kinetic war in Ukraine and the related threat to European Union Member States has resulted in an increase in public expenditure on the modernization of the army. The vast majority of NATO states have begun to pay more attention to arms expenditure, mostly fulfilling the alliance's commitments that arms expenditure should be at least 2% of GDP. So, modern states feel great pressure internally as well as externally when it comes to the spending side. This would not be unusual if the public expenditure was covered by the tax revenues they generate. However, in the global world of the digitalized economy, modern states are facing great spending pressures, with concomitant problems with ensuring an adequate level of government revenue. This is exacerbated by the information asymmetry, which favors multinational corporations that often use aggressive tax optimization. On the other hand, states' policies towards taxpayers have also changed in response to that. In the so-called post-BEPS world, we are dealing with an increased number of tax controls, constantly tightening cooperation between tax authorities on information exchange, increased tax obligations, rising compliance costs, and, consequently, very high tax uncertainty, which may involve a lot of capital on the part of large companies. This situation is prompting both taxpayers and tax authorities to change their mutual relationship.

The traditional relationship between taxpayers and tax authorities is based on the authority of the latter and the subordination of the former. This is the so-called vertical model. In this model, verification of compliance with tax law takes place *ex-post*. This means that the taxpayer recognizes the tax facts and, appropriately applying the tax law, determines the tax liability by paying the tax due to the tax authority. Thus, any irregularities that may arise are usually detected after the deadline for payment of the tax has passed. It is often the case that such liabilities lapse without the tax authority being satisfied. This can occur, for example, if the taxpayer fails to demonstrate all tax facts and the tax authority fails to carry out proper control.

Meanwhile, for several years now, attempts have been made to introduce a new approach to the tax authority-taxpayer relationship, which would break the pattern of mere authority and subordination by introducing an element of cooperation based on mutual trust. This is the so-called horizontal relationship model. The main objective of such an approach is the voluntary and, at the same time, correct fulfilment of the tax liability by the taxpayer, which, in turn, will result in the reduction of costs related to tax inspections (controls) and law enforcement on the part of the tax authorities. Indeed, literature notes that taxpayers can cooperate with the tax authorities and, therefore, fulfil their tax obligations as long as the interaction between the tax authorities and the taxpayers is perceived as fair, i.e. transparent, accurate, and in line with proper procedures.[4] The purpose of this model, as opposed to the horizontal model, is to verify a taxpayer's compliance with tax laws *ex-ante*, that is, before a tax liability arises or after it has arisen but before it is due. By properly cooperating with the taxpayer, the tax authorities can diagnose emerging tax risks and eliminate them. Thus, they can ensure proper fulfilment of the tax liability and, consequently, certain revenues to the state budget. This form of cooperation is, therefore, more effective than if the verification of the correctness of the tax liability were to take place *ex-post*. The advantage for the taxpayer, in this case, will be the certainty of the correct enforcement of the tax liability, and thus the avoidance of sanctions as well as the costs associated with securing sufficiently high financial reserves created to cover possible uncertain

[4] Eduard Müller, "Steuern und Governance," *Austrian Law Journal*, no. 1 (2014): 112–9.

tax positions. The price for having the taxpayer's certainty as to the correct discharge of the tax liability is its transparency manifested by making available to the tax authorities all the information necessary to verify the correct discharge of the tax liability.

However, for this model to succeed in a given tax system, it must be based on mutual trust and characterized by enhanced cooperation between the tax authority and the taxpayer. A key issue therefore turns out to be the level of trust in public authorities, or the state more broadly. This is a significant issue, for two reasons. Firstly, from the very beginning of treasury, relations were based on the power of the tax authorities, and the authorities themselves, equipped with *imperium*, treated taxpayers according to a concept attributed to contemporary Feliks Dzierżyński. He was said to adhere to the principle that there are no innocent people, only badly interrogated ones. Applying the above to tax law, it would therefore have to be said that the tax authorities have, since their inception, acted according to the belief that there are no honest taxpayers, only poorly controlled ones. In such a situation, it is extremely difficult to require taxpayers to shed their previous prejudices by displaying complete transparency and trust towards the tax authorities. This requires sufficient time. Secondly, in addition to the above difficulties in restoring trust in tax authorities, there is also the cultural context, which is strongly rooted in the historical experience of specific societies. Indeed, it should be noted that the level of trust in public authority varies between the societies concerned. A certain relationship should be noted, according to which where the state has been oppressive towards the people, or a given society has not been able to create a state, and for several years has been dominated by a culturally alien authority, a lower level of trust in public institutions is observed. Undoubtedly, the quality of revenue administration is of great importance for the gradual restoration of trust where it is low. In particular, this refers to the substantive preparation of tax authority staff. This can either determine the success or failure of the cooperative compliance programme.

A fundamental problem facing the tax administration is changing the staff's mentality. Employees assigned to participate in the project on behalf of the tax authorities need to move on from an inquisitorial conduct of proceedings to consensual relations based on full understanding, openness, and rapid response to taxpayer problems. An important issue from

the point of view of the tax authorities is that staff should be adequately trained so that they thoroughly understand the specifics of the business, as well as the broader context of the transactions carried out by the taxpayer. An additional factor that affects the level of trust in the tax authorities is that the cooperative compliance programme should not be over-regulated in legal terms. Both the taxpayer and the tax authority must have the opportunity to base their mutual relations on cooperation aimed at discerning, together with the taxpayer, the most optimal solutions for the application of tax law. This does not mean, however, that the legislator should not give a normative shape to cooperation between tax authorities and taxpayers at all. The lack of a legal mandate for cooperative compliance may lead to a programme that ends in complete failure. This has been the case in Sweden, where cooperation between authorities and taxpayers is not regulated by common law, but by non-binding guidelines developed by the Tax Agency, which can be changed from day to day thus leading to a lack of predictability.[5] In response to less trust in the tax authorities, instruments are being created to encourage taxpayers to participate in the cooperative compliance programme.

The benefit for taxpayers cooperating with the authorities is reduced uncertainty. However, this preference is not always sufficiently encouraging. Hence, in many countries, other benefits can be observed, which are usually related to procedural issues. These include, for example, the complete abandonment of tax control or a significant reduction in both the quantity and quality of such proceedings.[6] The abandonment of controls or their significant reduction for participating taxpayers is in line with the concept of cooperative compliance, which should be based on trust. Indeed, it has been argued in the literature that, from the taxpayer's point of view, the vision of control can lead to minimized communication with the tax authorities and

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[5] Anna-Maria Hambre, "Cooperative Compliance in Sweden: A Question of Legality," *Journal of Tax Administration* 5, no. 1 (2019): 6–25; Lotta Björklund Larsen, "SWEDEN: Failure of a Cooperative Compliance Project?," *FairTax Working Paper Series*, no. 7 (December 2016); Lotta Björklund Larsen, "What Tax Morale? A Moral Anthropological Stance on a Failed Cooperative Compliance Initiative," *Journal of Tax Administration* 5, no. 1 (2019): 26–38.

[6] However, in Belgium, participation in the programme does not exempt from the possibility of tax control, see: Francesco Cannas and Kristof Wauters, "The Rise of Cooperative Compliance Programmes and the Rule of Law: A Comparison between Belgium and Italy," *European Taxation*, no. 12 (December 2019): 567.

also negatively affect relational attitudes.[7] Another benefit of participating in the programme may be the reduction of tax sanctions. This usually refers to interest on arrears, but also penal sanctions of a criminal nature.[8] An additional benefit for taxpayers is that they can obtain an interpretation from the tax authority on the application of tax law more quickly. In Italy, for example, the period for issuing individual interpretations has been reduced from 90 to 45 days.[9]

When analyzing cooperative compliance solutions, it should be noted that while there is no single model in this respect, the literature notes that there are three common features. The first is the risk assessment, which involves a more or less thorough monitoring of the taxpayer. The second is the real-time work between the taxpayer and the tax authority aimed at preventing the incorrect enforcement of the tax liability. This is because it avoids unnecessary disputes. The third is mutual understanding. On the one hand, the authorities care about the quality of staff so that the complexity of economic relations can be better understood, while on the other hand, taxpayers declare full transparency in exchange for greater legal certainty.[10]

3. Characteristics of the Polish Cooperative Compliance Programme

Cooperative tax compliance, known as a cooperation agreement, was introduced into the Polish legal system on July 1, 2020. The Polish legislator decided to make the institution in question an elite programme available only to the largest taxpayers meeting appropriate quantitative as well as qualitative

[7] Vincent Lacombe, Laëtitia Banos, and François Garcia, "Contrôle fiscal des grandes entreprises: les nouvelles approches des administrations anglo-saxonnes peuvent-elles inspirer une évolution en France?," *Revue de Droit Fiscal*, no. 49 (December 2012): 6–7.

[8] See more: José Andrés Rozas Valdės and Enza Sonetti, "Tax Penalties in a Cooperative Compliance Framework," *Rivista di Diritto Tributario Internazionale*, no. 2 (2014): 44–50; César García Novoa and Rosa Caballero Perdomo, "El Compliance tributario, la relación cooperativa y las nuevas relaciones fiscales. Su implantación en España y en América Latina," *Revista de Fiscalidad Internacional y Negocios Transnacionales*, no. 12 (2019): 20–2.

[9] More on the benefits of participating in the programme in Italy, see: Luigi Quaratino, "Italy's Cooperative Compliance Regime Broadened in Scope under 2023 Tax Reform Law," *European Taxation*, no. 11 (November 2023): 501–2.

[10] See: Lotta Björklund Larsen and Lynne Oats, "Taxing Large Businesses: Cooperative Compliance in Action," *Intereconomics*, no. 3 (2019): 167.

criteria. The formal framework of the programme is regulated in the Tax Ordinance Act.[11] The Polish programme is largely similar to the Austrian programme.[12] The programme is open to taxpayers whose revenue value resulting from the corporate income tax return for the previous tax year exceeded the equivalent of EUR 50,000,000. Poland has approximately 2,500 entities that meet the quantitative criterion set out above. Meanwhile, 12 taxpayers were participating in the pilot programme at the end of June 2024.[13] Unlike the Dutch solutions, where both large and medium-sized taxpayers can participate in the programme,[14] the Polish regulations only allow large taxpayers to participate in the programme. This is the case because, firstly, they have adequate internal structures to meet the criteria of the programme and, secondly, aggressive tax planning is most common among this group.[15] However, it should be noted that the Polish legislator is planning to lower the quantitative criterion so that a larger number of entities can be included in the programme. There are also plans to allow medium-sized companies to join the programme.

In contrast to the British solutions,[16] entry into the programme is voluntary and takes place at the request of the interested taxpayer. This takes place based on a tax agreement between the taxpayer and the Head of the National Revenue Administration. As provided in the Tax Ordinance Act, joining the agreement serves to ensure the taxpayer's compliance with the provisions of tax law in conditions of transparency of actions taken and mutual trust and understanding between the tax authority and the taxpayer, taking into account the nature of the taxpayer's business.[17] This is preceded by a preliminary audit in which the tax authorities assess the risks

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11 Act on the Tax Ordinance of 29 August 1997, Journal of Laws 2023, No. 2383, as amended, hereinafter referred to as Tax Ordinance Act.

12 Florian Fiala and Lisa Ramharter, "Cooperative Compliance in Austria," *European Taxation*, no. 8 (August 2019): 385–90.

13 "Program współdziałania," gov.pl, accessed July 10, 2024, https://www.gov.pl/web/kas/program-wspoldzialania.

14 José A. Rozas Valdés, *Los sistemas de relaciones cooperativas: una perspectiva de derecho comparado desde el sistema tributario español* (Madrid: Instituto de Estudios Fiscales, 2016), 69–84.

15 Explanatory memorandum to the draft law of 16 October 2019 on the settlement of double taxation disputes and the conclusion of advance pricing agreements

16 Rozas Valdés, *Los sistemas de relaciones cooperativas*, 49–67.

17 Article 20s § 2 of the Tax Ordinance Act.

and, on this basis, decide whether to include the applicant taxpayer in the programme. In this context, the issue of risk assessment should be taken into account. It is important from the point of view of the cooperative compliance programme.

In the traditional model of the taxpayer-tax authorities relationship, based on a vertical relationship, the assessment of risk, equated with the failure to properly perform a tax obligation, is, as a rule, expected to be performed by the tax authority. This is because the tax authorities, due to the asymmetry of information, make their assessment by determining the probability of non-performance of the tax liability based on the taxpayer's past behavior, analyses of unusual transactions, or industries in which tax fraud is quite common. However, in a model based on a horizontal relationship, the problem of assessing risk presents itself in a slightly different way. Firstly, since cooperative compliance is based on mutual trust, given that the taxpayer has voluntarily joined the programme, should the taxpayer be vetted at all for the risk of tax default? In most countries with a cooperative compliance programme, entry into the programme is conditional on undergoing an initial risk assessment, as it is, in principle, designed for taxpayers with reliable tax compliance. Given certain preferences provided to taxpayers participating in the programme, the tax authorities want to ensure that unreliable taxpayers do not join it. This is based on the principle: trust, but verify.

Another problem occurring at the level of risk analysis is who is to monitor the risks in the course of the programme. Whether this is to be the tax authority or the taxpayer itself under internal procedures accepted and prescreened by the tax administration and reported back to the relevant tax authority when detected. For example, in the UK, the risk assessment is carried out by a representative of the tax authority, while in the Netherlands, the taxpayer is usually responsible for the assessment.[18] In Poland, an approach similar to the Dutch one has been adopted, i.e. upon entering the programme, it is the taxpayer's responsibility to identify the risks that

[18] See more: Dennis de Widt and Lynne Oats, "Risk Assessment in a Co-operative Compliance Context: A Dutch–UK Comparison," *British Tax Review*, no. 2 (2017): 230 et seq. See also: Hans Gribnau, "Horizontal Monitoring: Some Procedural Tax Law Issues and Their Broader Meaning," in *Tax Assurance*, eds. Ronald Hein and Ronald Russo (Deventer: Wolters Kluwer, 2022), 215–52.

may lead to the tax liability not being properly performed. The practice adopted in Poland is mainly based on the creation of appropriate internal control mechanisms within the organizational structure of the taxpayer. Their development and appropriate application are intended to minimize the risk of tax liabilities not being met at all or being met only partially. During the cooperative compliance agreement, the tax authority carries out a monitoring audit, the purpose of which is essentially to verify the internal and external control mechanisms.

Participation in the cooperative compliance programme creates certain obligations for the taxpayer to demonstrate transparency to the tax authorities. Hence, taxpayers are obliged to promptly report potentially contentious issues as well as any tax benefits obtained. In addition, at a frequency agreed in the plan developed with the tax authority, taxpayers are required to report the Single Audit File, tax schedules, and internal and external audit findings. The tax authorities should also be informed of significant financial, accounting, or legal events that take place in the company and planned and implemented changes to the internal control structure. In addition, once a year, the tax authorities should be informed of the annual operational, financial, and tax plans; reports relating to the operation of the internal control framework; a report on taxes paid in the country and other tax jurisdictions; and the calculation of current and deferred tax to the company's balance sheet result.[19]

In exchange for greater transparency and openness of taxpayers towards the tax authorities, the Polish legislator has provided some preferences. These apply only to taxpayers participating in the cooperative compliance programme. The first of these appears already at the stage of the preliminary audit based on which, assessing the tax risk identified by the taxpayer, the Head of the National Revenue Administration decides to agree with the taxpayer. It should be pointed out that, in the case of a taxpayer for whom, in the course of a preliminary audit, irregularities in the performance of tax obligations have been identified, a correct submission of a tax

[19] "Wytyczne w zakresie Ram Wewnętrznego Nadzoru Podatkowego," Krajowa Administracja Skarbowa, Warsaw, 2020; "Podręcznik dla uczestnika Programu Współdziałania," Krajowa Administracja Skarbowa, Warsaw, 2020, accessed July 10, 2024, https://www.podatki.gov.pl/program-wspoldzialania/dokumenty-programu-wspoldzialania/.

return or correction of a tax return will be made, together with the payment of tax arrears, a penalty interest will be charged at a reduced rate of 50%.[20] A similar preference will apply if a taxpayer files a return or a correction to a return and pays the tax arrears for the periods in which irregularities occurred, but which were not covered by the preliminary audit.[21] It should be noted that the above preferences apply to any taxpayer that will be subject to a preliminary audit, even if such a taxpayer did not ultimately enter into the cooperative compliance programme (due to the taxpayer's final withdrawal or a negative audit result). Advantageous solutions are also provided for taxpayers who have already joined the programme and are subject to a permanent monitoring audit. Then, if it turns out during such an audit that the taxpayer has not correctly fulfilled a tax obligation despite participating in the programme, penal default interest is not charged after the taxpayer submits a return or a correction to the tax return together with the payment of the tax arrears. In addition, fiscal penalties are not enforced, as no proceedings for fiscal offences or fiscal misdemeanors are initiated against such a taxpayer.[22] The above regulations result from the adoption of the concept that, if an incorrect performance of a tax liability has occurred during the cooperative compliance programme, the blame for such a fact lies not only with the taxpayer but also with the tax authority, which was not able to diagnose the tax problem and draw attention to it within the framework of the monitoring audit.[23] In addition, the possibility of tax control by the locally competent tax authority is excluded for taxpayers who have entered into a cooperation agreement with the tax authority. The only entity that may carry out control is the Head of the National Revenue Administration.

The above-mentioned preferences protect taxpayers against self-assessment errors. However, if a taxpayer joining the programme would like to obtain greater protection, he or she may additionally conclude a tax agreement with the Head of the National Revenue Administration. Its subject

[20] Article 20zm § 1 point 1 of the Tax Ordinance Act.

[21] Article 20zm § 2 of the Tax Ordinance Act.

[22] Article 20zm § 3 of the Tax Ordinance Act.

[23] See more: Włodzimierz Gruba, "Komentarz do art. 20zm," in *Ordynacja podatkowa. Komentarz*, eds. Stefan Babiarz et al. (Warsaw: Wolters Kluwer, 2024), 235–6.

may be the interpretation of tax laws; the determination of transfer prices; the lack of legitimacy for the application of an anti-avoidance clause. In addition, a tax agreement may be concluded to determine the amount of corporate income tax liability projected for the next tax year, as well as in any other matter necessary to ensure proper implementation of the cooperation agreement. The purpose of agreeing is to provide the taxpayer with certainty in the application of tax law without the need to initiate formal proceedings on the subject covered by the agreement. An additional benefit for the taxpayer is also the halving of the rate of fees payable in previous price agreements or safeguard opinions. It should further be pointed out that the fees themselves are only charged if an agreement is concluded.[24] The conclusion of an agreement is possible once both parties agree on the legal issues covered by the agreement. Hence, the taxpayer has no legal remedy in the form of an appeal or a complaint to the administrative court ruling on tax matters.

4. Cooperative Compliance and the Constitutional Principle of Equality

The legal basis for the imposition of taxes and other public levies in Poland is Article 84 of the Constitution,[25] according to which everyone is obliged to bear public burdens, including taxes, as defined by law. It expresses the principle of universality of taxation. On the other hand, taxpayers are protected from excessive state fiscalism by Article 217 of the Constitution, in which the principle of *nullum tributum sine lege* is normalized. It stipulates that taxes and other public levies can be imposed only by law. Moreover, such structural elements of taxes as the subject, object of taxation, tax rates, as well as the principles of granting reliefs and remissions and categories of entities exempt from taxes should be standardized in the law. It should be emphasized that, in the field of taxation, it is of utmost importance that it be fair, which is often equated with the principle of equality. This principle is expressed in Article 32(1) of the Constitution, according to which everyone is equal before the law, and everyone has the right to equal treatment by

[24] Article 20zc § 4 point 1 and Article 20zc § 5 point 2 of the Tax Ordinance Act.

[25] The Constitution of the Republic of Poland, Journal of Laws 1997, No. 78, item 483, as amended, hereinafter referred to as Constitution.

public authorities. Therefore, it should be pointed out that since the Constitution indicates the principle of equality before the law, the consideration of equality in the context of cooperative compliance should focus only on the sphere of law. It should therefore be noted that the Polish Constitution does not seek to establish absolute equality, but eliminate unjustified differentiation.

The jurisprudence of the Constitutional Tribunal points to two elements of equality before the law. The first is an order for equal treatment by public authorities in the process of applying the law. The second consists of an injunction to shape the content of the law in such a way that the principle of equality is taken into account.[26] In the context of the present discourse, the issue of equality will refer to equality before lawmaking. In the literature on the subject, it is indicated that it should be understood as an obligation to create legal regulations in such a manner that they satisfy the imperative of equal treatment of entities in similar situations.[27] The jurisprudence of the Constitutional Tribunal indicates that the principle of equality before the law requires that the addressees of legal regulations, characterized equally by a given essential feature, should be treated equally. This means that they should be treated according to one measure, both without discriminatory and favorable differentiations.[28]

Thus, in the light of case law, it is permissible to differentiate between entities based on the relevant characteristic they possess, the so-called relevant characteristics. Hence, the derogation from the principle of equality must be based on relevant criteria. The jurisprudence of the Constitutional Court therefore allows for a different treatment of addressees of a legal norm who share common characteristics, provided that certain criteria are met. Firstly, the derogation from the principle of equality must be relevant. This means that it should be directly related to the aim and essential content

26 Polish Constitutional Tribunal, Judgment of 9 March 1988, Ref. No. U 7/87; Polish Constitutional Tribunal, Judgment of 31 March 1998, Ref. No. K 24/97.

27 Witold Borysiak and Leszek Bosek, "Komentarz do art. 32," in *Konstytucja RP*, vol. 1, eds. Marek Safian and Leszek Bosek (Warsaw: Wolters Kluwer, 2016), 833–4; Bogusław Banaszak, *Konstytucja Rzeczpospolitej Polskiej. Komentarz* (Warsaw: C.H. Beck, 2012), 225–34.

28 Polish Constitutional Tribunal, Judgment of 9 March 1988, Ref. No. U 7/87; Polish Constitutional Tribunal, Judgment of 11 April 1994, Ref. No. K 10/93; Polish Constitutional Tribunal, Judgment of 18 October 2011, Ref. No. SK 2/10.

of the provision in which the controlled norm is contained. In addition, it must serve that purpose and content. Secondly, the importance of the interest serving to differentiate the situation of the subjects is relevant. It is emphasized that it must not be inferior to interests that will not be fully taken into account. Third, it must be in line with other constitutional values, principles, and norms that justify different treatment of similar subjects.[29]

Referring the above to the issue of Polish cooperative compliance regulations, one may wonder whether the adopted provisions violate the constitutional principle of equality. As a rule, a taxpayer participating in the programme does not obtain a direct benefit in the form of a reduction of the tax burden. This means that being in the same factual situation as entities without an agreement with the Head of the National Revenue Administration, the taxpayer is obliged to pay tax in the same amount. However, certain regulations concerning the concept of cooperation may raise concerns as to whether the principle of equality is observed.

First of all, attention should be drawn, as mentioned above, to the substance of the scheme. From the point of view of the taxpayer, participation in the programme results in greater certainty as to the application of tax law, and thus in a possible reduction of tax costs, related, for example, to the absence of disputes between the taxpayer and the tax authority, or a reduced number of tax controls that may generate higher costs for the taxpayer. In addition, it should be pointed out that further preferences have been granted to participants in the programme. In a sense, they are intended to encourage more taxpayers to participate in the programme. Because of the above, it should be considered whether a relevant feature could be attributed to the taxpayers participating in the programme. As indicated above, the main objective of the programme is to increase government revenue by improving the efficiency of tax compliance. By design, this objective should be realized by changing the model of the taxpayer-tax authority relationship from vertical to horizontal. This is manifested namely by building trust, mutual understanding, and transparency. The above-mentioned

[29] Polish Constitutional Tribunal, Judgment of 22 February 2005, Ref. No. K 10/04; Polish Constitutional Tribunal, Judgment of 15 July 2010, Ref. No. K 63/07; Polish Constitutional Tribunal, Judgment of 9 July 2012, Ref. No. P 59/11; Polish Constitutional Tribunal, Judgment of 28 September 2015, Ref. No. K 20/14; Polish Constitutional Tribunal, Judgment of 23 April 2020, Ref. No. SK 66/19.

objective would therefore have to be examined through a derogation from the principle of equality. Whether it is in direct relation to the purpose and content of the provision and whether it serves this purpose and content. As was already indicated, the scheme is designed for large taxpayers who, with the right internal structures, have the potential to carry out aggressive tax optimization that adversely affects state budget revenues.

Hence, the Polish regulations introduced a quantitative criterion whereby only entities whose revenues resulting from the corporate revenue tax return for the previous tax year exceeded the equivalent of EUR 50,000,000 could participate in the programme. Of course, an objection could arise as to how the above quantitative criterion was established. Does this way of defining taxpayers as large entrepreneurs violate the principle of equality before the law? It should be noted, however, that in the case of Polish solutions, qualitative criteria have been introduced in addition to the quantitative criterion, which in a way justifies the possibility of making the programme available to a given group of taxpayers. According to the aforementioned criteria, to become a participant in the programme, a taxpayer must manifest the will to correctly fulfil the tax obligation, i.e. in practice definitively give up an aggressive tax optimization. In addition, the taxpayer's willingness to pay its tax obligations correctly is not sufficient in itself, as it should have or be able to establish an adequate internal control framework through which it is possible to monitor whether tax laws are being complied with. It is argued in the literature that it is the creation of a proper internal control framework by the taxpayer that is central to the concept of cooperation, as it serves as an objective justification for the tax authorities' trust in the taxpayer.[30]

In addition, it should be noted that within the traditional vertical relationship between the taxpayer and the tax authority, there is, as mentioned above, an information asymmetry. This means that the tax authorities do not have full information about the taxpayer. The taxpayer himself, as far as he can, does not voluntarily share such data that could help the tax authorities to correctly assess the tax facts. This applies mainly to large taxpayers who can afford to operate across borders, often performing aggressive tax

[30] Eelco van der Enden and Katarzyna Bronzewska, "The Concept of Cooperative Compliance," *Bulletin for International Taxation*, no. 10 (October 2014): 572.

optimization. It should be pointed out that the situation of taxpayers participating in the cooperative compliance programme is therefore different from those who are not included in the programme. This is because the taxpayer when deciding to cooperate, undertakes to be transparent by providing the tax authorities with information leading to minimizing the risk of non-performance of a tax obligation.

In the jurisprudence of the Constitutional Tribunal, it is argued that the principle of equality should bind the legislator in particular about the imposition of obligations on taxpayers.[31] Since tax and other levies significantly interfere with the right to property, which is constitutionally guaranteed, the equal imposition of obligations on taxpayers is in line with Article 64(2) of the Constitution, which states that property, other property rights, and the right of inheritance are subject to equal legal protection for all. In principle, the property right may be restricted by the need to impose taxes, which follows from the principle of universality of taxation expressed in Article 84 of the Constitution. However, it is argued in the literature on the subject that interference with the right to property by tax law should take place according to the principle of equality, as otherwise, it would contravene the constitutional principle of a democratic state of law.[32]

The principle of equality should also correspond with another constitutional principle of freedom of economic activity. Because of the above, it should be noted that although a taxpayer participating in the programme obtains a kind of procedural advantage, greater obligations are imposed on him than on taxpayers not participating in the programme. As already indicated above, these consist, in particular, of making information fully available to the tax authorities by submitting, for example, to monitoring audits or providing data to the tax authorities covered by the cooperation agreement. It should be noted, however, that the taxpayer agrees to take on the above obligations. It does so in exchange for a guarantee of legal certainty, which, in the case of large taxpayers, makes it possible to release financial reserves that are created for uncertain tax positions. Undoubtedly,

[31] Polish Constitutional Tribunal, Judgment of 24 April 2001, Ref. No. U 9/00; Polish Constitutional Tribunal, Judgment of 8 May 2001, Ref. No. P 15/00.

[32] See more: Adam Krzywoń, *Podatki i inne daniny publiczne w Konstytucji Rzeczpospolitej Polskiej* (Warsaw: Wydawnictwo Sejmowe, 2011), 86–8.

the weight of interest thus serves to differentiate the situation of taxpayers participating in the scheme.

Indeed, since the aim is to improve compliance with the law and thus not to deplete budget revenues, the differentiation of taxpayers within the scope of the cooperative compliance programme must be considered to comply with the principle of proportionality. Moreover, the differentiation of the entities participating in the programme in this case remains to other values, principles, and constitutional norms recognizing the different treatment of similar entities. On the other hand, the preferences granted to the taxpayers covered by the scheme themselves do not position the taxpayer in such an advantageous position. Firstly, the advantage consisting of the payment of lower interest on arrears results from the voluntary submission to a preliminary audit, thanks to which the tax authorities can verify the correctness of the fulfilment of the tax obligation without the need to carry out often costly audits preceded by analytical work of the employees of the tax authorities. As a result of catching irregularities following from voluntary submission to a preliminary audit, there is no loss of revenue to the state budget. In all probability, such a loss would have occurred if the taxpayer had not expressed a willingness to cooperate with the tax authority. On the other hand, the abandonment of the imposition of a sanction on a taxpayer covered by the programme who has not correctly performed a tax obligation is based on the idea that responsibility for the incorrect performance of such an obligation is also to be borne by the tax authority, which, while constantly cooperating with the taxpayer, failed to notice a significant problem in the correct application of the tax law by the taxpayer. Similar conclusions should also be reached in the context of the possibility of a tax agreement between the taxpayer and the Head of the National Revenue Administration. It is true that, on the one hand, the taxpayer obtains information on the application of tax law more quickly, and thus other taxpayers obtain faster certainty that the tax obligation will be executed correctly. On the other hand, however, the provision of information on the taxpayer's transactions, together with other necessary information, leads to a reduction in the costs of administrative proceedings, which is not possible for those taxpayers whose relations with the tax authority are based on the traditional vertical model.

5. Conclusions

The above considerations lead to the conclusion that Polish regulations on cooperative tax compliance do not violate the constitutional principle of equality. First of all, it should be noted that they were introduced to improve compliance with the tax law, and thus they limit the possibility of depletion of state budget revenues. Hence, the differential treatment of large taxpayers covered by the cooperation scheme from other taxpayers is in line with the principle of proportionality. It is argued in the literature that, as long as the benefits of compliance cooperation are limited to procedural proceedings, the programmes should be considered proportionate.[33] As indicated above, the Polish regulations are *de facto* limited to benefits of a procedural nature, and a taxpayer participating in the programme cannot count on a reduction of the tax liability. As already explained, the reduction of penalty interest cannot be considered as such. Undoubtedly, therefore, both the purpose of the enactment of the law relating to cooperative compliance and the position of the taxpayer participating in the programme, who makes all information about himself available in the framework of being transparent, makes his situation not the same as that of taxpayers not participating in the programme. Indeed, it should be noted that in this case, we are dealing with a different situation which, in combination with the other constitutional norms mentioned above, justifies a different treatment of similar entities. Thus, the legal provisions on cooperative compliance do not violate the constitutional principle of equality.

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[33] Alicja Majdanska and Jonathan Leigh Pemberton, "Different Treatment, Same Outcome: Reconciling C-Operative Compliance with the Principle of Legal Equality," *Journal of Tax Administration* 5, no. 1 (2019): 137; See: Fabrizio Amatucci, "Proportionality Principle and Tax Compliance: New Limits for Tax Authorities," in *New Taxation. Studies in Honor of Jacques Malherbe*, eds. Catalina Hoyos Jiménez, César García Novoa, and Julio A. Fernández Cartagena (Bogotá: Instituto Colombiano de Derecho Tributario, 2017), 187–94.

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The Hungarian Retail Sales Tax in the Changing EU Context

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Abstract: In the last twenty years, Hungary has had three periods of special taxes (introduced as a result of the crises), but before and after 2010, and after the recession following the COVID-19 epidemic and the Russian-Ukrainian war, there were different legal policy reasons behind special taxes (including the retail sales tax). This raises questions as to whether the regulatory solutions implemented to address market failures during the first period are playing the same role today as they did in the past, and how their role has changed over the years. The introduced taxes often remain part of the general tax system, i.e. they are applied on a permanent basis (rather than on a temporary basis, as is usual with special taxes), and in 2023 they already accounted for almost 14% of total tax revenue (a higher proportion than, for example, corporate tax), which puts their role in the tax system in a different light. The Court of Justice of the European Union (CJEU) has repeatedly examined the EU framework, but it appears that the control has been weakened, mainly due to the impact of the current crises. At the same time, the Hungarian Constitutional Court is bound by the limits of the debt brake when examining the constitutional framework. The study explores the regulation of the Hungarian retail sales tax and its EU context, in particular with regard to the changes triggered by the crises.

1. Introduction

The regulation and practical application of the Hungarian retail sales tax have been referred to the Court of Justice of the European Union in several cases. The difficulty in deciding the issue is mostly attributable to the fact

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that while tax policy is a national competence and raises sensitive sovereignty issues, the assessment of the compatibility of aid measures with EU law falls within the exclusive competence of the European Commission. The cases brought before the CJEU concerning the Hungarian retail tax show that the issue is far from straightforward. It is already difficult to determine whether the issue is within the realm of tax or state aid policy and, if state aid is involved, its permissibility may also be open to debate.

Therefore, after presenting the background of the Hungarian retail sales tax, this paper will analyze two retail sales tax decisions before the Court of Justice of the European Union (CJEU), as they may shed light on new trends in the context of the crisis.

The cases before the CJEU have been examined under the preliminary ruling procedure, which will presumably show that the Court of Justice is taking account of changing Community policy trends in its rulings and that the crisis has led it to adopt more lenient rulings for Member States and to make less consistent efforts to adapt to its previous case law. Thus, the change in the legal policy behind the special taxes in the wake of the crises has been coupled with a permissive attitude on the part of the European Union.

2. Taxes on the Retail Sector: Special or Extraordinary Tax?

It is argued here that the term "special tax" is more appropriate than "extraordinary tax," because it is precisely the temporal scope of the extraordinary nature of this tax that may be in question. The term special tax is an apt description of the difference between these special taxes and the traditional main taxes. At present, the special retail tax in a way complements the traditional tax system, and it is therefore necessary to examine how it can be integrated into the tax system. This study uses the term sectoral special tax because the burden on the retail sector is specific as it applies to this sector in a variety of ways. The lesson of the three special tax reform periods of the past decades is that it is difficult to define the exceptional and temporary nature of special tax.[1] On the one hand, since it is a crisis tax, the legislator often does not know in advance how long special tax will be in force. Even

1 Péter Darák and Dóra Lovas, "Az adórendszer deszantosai: a különadók," *Jogtudományi Közlöny*, no. 11 (2023): 481–91.

if the law contains an expiry date, it is often extended in the meantime. This suggests that special tax is adapted to the duration of the budgetary revenue squeeze. One can never know in advance how long a special tax will last.[2] The specific time limits of the statutory scope of special tax overshadow the fact that it is justified to maintain special tax for as long as the circumstance giving rise to it exists. It raises questions as to whether, once the triggering event has ceased to exist, the special tax must necessarily also cease to exist or whether it can remain part of the tax system. It is also unclear whether its abolition can be enforced under public law. These questions are not yet answered by jurisprudence.

Even if the special tax is a specific form of public revenue, its principles cannot be radically different from those of taxes in general. It must be fair, neutral and proportionate, it must fulfil a redistributive and behavioral function, it must help to mitigate market failures and foster economic development, but it must not seriously distort the market, it must not threaten stability and it must not be confiscatory. The introduction of special taxes is characterized by at least one aspect of cautious care on the part of the legislator, namely that it selects the taxable subject and, in most cases, the taxable person to match it, with great care. This caution is fully justified in light of the delicate competitive situation in the market. It can also be observed that the legislator often corrects ex post excessive tax rates that have a detrimental effect on market conditions.[3]

3. History of the Retail Sales Tax between 2010 and 2020

3.1. Theoretical Issues

The early 2000s saw a rapid expansion of discount chains around the world, changing the balance of power in the market and reorganizing the structure of traditional retailing.[4] However, in the Hungarian context, these

2 Gabriella Csűrös, "Tax System in Hungary and Its Changes Due to the Crisis – Pioneer or Hazardous Method of Sectoral Taxation?," in *Tax Authorities in the Visegrad Group Countries: Common Experience after Accession to the European Union*, eds. Marcin Burzec and Paweł Smoleń (Lublin: Katolicki Uniwersytet Lubelski Jana Pawla II, 2016), 85–113.

3 Csűrös, "Tax System in Hungary and Its Changes Due to the Crisis," 85–113.

4 Noémi Hajdú, "Mi az Aldi kereskedelmi titka, amivel meghódította a magyarok szívét? A választ itt találja," in *Marketingkaleidoszkóp 2017. Tanulmányok a Marketing és Turizmus Intézet kutatási eredményeiből*, ed. István Piskóti (Miskolc: Miskolci Egyetem Marketing Intézet, 2017), 112–9.

discounters were mainly foreign-owned, while the Hungarian chains were large in number, but they were cooperative and most of the members had only independent, spontaneously organized small shops. Their cooperation is also inadequate, as they are often limited to certain sub-regions and thus operate in a highly decentralized manner. Hungarian franchised chains (e.g. CBA) could not compete with large international chains in terms of price and product range.[5]

In Hungary, the shop retail sector tax[6] was first introduced for a limited period (2010–2012). The aim was to improve the balance of public finances, which had been disrupted following the 2008 global economic crisis, taking into account the ability of retailers to bear the burden.[7] The special tax was based on turnover rather than profit and was applied progressively to individual taxpayers. It was later criticized most for these features. On the one hand, the use of turnover instead of profit was misleading, as the retail sector was also loss-making after the 2008 global economic crisis, and on the other hand, the progressivity of the tax was controversial, as it hit large commercial companies – mainly foreign ones – harder than legally independent companies[8] – mainly Hungarian ones.

When the retail sales tax is introduced, it can be considered a crisis tax, as most of this type of tax was introduced in Hungary as a result of the global economic crisis in 2008. The main reason for introducing a special tax is its flexibility, as it can quickly resolve or mitigate crises and ensure the stability of public finances. The Hungarian government quickly realised the benefits of such a special tax, as it can generate significant fiscal revenues and strengthen domestic companies.[9] Between 2010 and 2012, there

5 Charles S. Mayer and Reza M. Bakhshandeh, "Global Vs. Local-The Hungarian Retail Wars," *Journal of Business & Retail Management Research* 10, no. 1 (2015): 149–58; Tamás T. Sikos and József Kovács Csaba, "Az élelmiszerdiszkontok helyzete, különös tekintettel a Coop-üzletlánccal Észak-Magyarországon folytatott versenyükre," *Területi Statisztika* 60, no. 6 (2020): 688–713.

6 Special tax on retail trade: 0.1% (between HUF 0.5 and 30 billion), 0.4% (between HUF 30 and 100 billlion), 2.5% (above HUF 100 billion).

7 Act XCIV of 2010 on the special tax on certain sectors.

8 The Hungarian retail companies concerned are mainly franchised.

9 Dániel Deák, "Szankcionálható-e az árbevételre vetített progresszív adó?," *Jogi Melléklet*, no. 9 (2020): 91–2.

were more than 150,000 operators in the retail sector.[10] The data also show that the number of retail outlets increased from 2010 to 2012 and then steadily declined from 2013, driven by the introduction of the special tax, the creation of national tobacconists, the development of an online check-out system and the ban on Sunday opening for one year in 2015. However, it is also clear that, despite the high number of retail outlets, the market is concentrated, with only a few large, typically foreign-owned multinationals concentrating the vast majority of profits.[11]

New rules were introduced in 2012, partly because the transitional special tax was planned to apply until the end of that year. In addition, under the EU's excessive deficit procedure, the Council of the European Union[12] decided in the summer of 2012 to suspend part of the EU's cohesion funds from January 2013 unless Hungary took meaningful fiscal adjustment measures to bring its public deficit below 3%.[13] At the same time, however, the special tax was subject to an EU procedure which called into question its legality in several respects. Therefore, the sector-specific tax on shop retailing was abolished. There have been other small attempts to intervene in the sector, but it was only reintroduced in 2020.[14] From 2012, a public health product tax[15] would apply, which, in addition to raising tax revenue for the state, was introduced to reduce the consumption of products that are harmful to health. It is also worth mentioning, as a burden on the retail sector, that VAT was increased to 27% for most products in 2012.

10 Food retail outlets account for less than 30% of the more than 150,000 shops. "Number of retail outlets by type of outlet," KSH, accessed March 9, 2024, https://www.ksh.hu/stadat_files/bel/hu/bel0002.html.

11 Gabriella Csűrös and Dóra Lovas, "The Boomerang Effect: Sectoral Extraordinary Taxes in Hungary (2006–2024)," *International Tax Law Review*, no. 2 (2023): 189–217.

12 2012/156/EU: Council Implementing Decision of 13 March 2012 suspending commitments from the Cohesion Fund for Hungary with effect from 1 January 2013 (O.J.E.C. L78, 17 March 2012), 19–20.

13 CJEU Judgment of 5 February 2014, Hervis Sport- és Divatkereskedelmi Kft. V. NTC, Case C385/12, ECLI:EU:C:2014:47.

14 For more on the context in which the special tax was introduced, see: Csűrös and Lovas, "The Boomerang Effect," 189–217.

15 Introduced by Act CIII of 2011 on the Public Health Product Tax, a turnover type tax. Its scope has been extended and increased over time, before being re-regulated as an extra-profit tax from 2022.

3.2. Analysis of Relevant Decisions of the CJEU

The special tax on the retail sector was introduced in 2010. This tax became part of the Hungarian tax system as a progressive type of tax, by taxing retail companies differently based on turnover. The compatibility of the tax with EU law was twice referred to the CJEU and, although similar issues were raised, different rulings were given.

As a starting point for the analysis of the cases, the TFEU draws a distinction between the rules on state aid[16] and the rules on tax[17] provisions of the Member States.[18] One of the reasons for this is that while the former is an EU competence, the latter is a Member State competence. Member State courts may have difficulties in deciding which category of national provision should be included and may even refer the matter to the CJEU for a preliminary ruling to determine compatibility with EU law. It should be noted that in both of the cases analyzed –the Hervis case and the Tesco case – the applicant invoked the existence of State aid, but only in the latter case did the CJEU address the issue.

In the Hervis case,[19] the CJEU examined for the first time the compatibility with EU law of the special sectoral retail tax rules introduced in 2010. At the heart of the problem was the fact that, when determining the retail tax base, affiliated companies – mostly foreign – were obliged to add up their turnover and pay the progressive rate on that basis.

In comparison, businesses operating in franchise form – mainly with Hungarian ownership – did not have to do the same. According to the Advocate General's Opinion in the case, it can be assumed that the Hungarian legislation does not discriminate and therefore does not infringe on the freedom of establishment,[20] but it would be worth examining whether it is compatible with the VAT Directive, which the CJEU cannot do without

16 Consolidated versions of the Treaty on European Union and the Treaty on the Functioning of the European Union (TFEU), 107–109.

17 TFEU 116 and 117.

18 CJEU Judgement of 11 July 2014, Distribuidora de Televisión Digital, SA, Case T-533/10, ECLI:EU:T:2014:629.

19 CJEU Judgment of 5 February 2014, Hervis Sport- és Divatkereskedelmi Kft. V. NTC, Case C385/12, ECLI:EU:C:2014:47.

20 Here, the Advocate General argues that the special retail tax is a turnover tax, but in the Tesco case it is a direct tax. See: Opinion of advocate general Juliane Kokott, Case C 323/18, para. 33.

the national court submitting a new request for a preliminary ruling on the interpretation of that act.[21]

The CJEU, however, considers that a national legislation that imposes a progressive flat-rate charge on turnover by requiring taxable persons that are affiliated to each other in a group of companies to aggregate their turnover (while they are mostly affiliated to companies established in other Member States) infringes the freedom of establishment. Thus, if there is discrimination, the Hungarian legislation is not compatible with European Union law.[22] In the Hervis case, the CJEU voted in favor of the progressive sector-specific tax being State aid, without making any specific statement to that effect. However, the CJEU cannot decide for the national court, so the Hungarian courts have been given the task of examining whether there is discrimination in that particular case (i.e. whether the taxpayers in the group of companies in the retail shop market of the Member State concerned and falling within the top tax bracket of the special tax are mostly companies established in another Member State). In 2014, the Hungarian court found, on the basis of the CJEU's interpretation of EU law, that the Hungarian legislation constitutes indirect discrimination. However, following an application for review by the defendant, the case was referred to the Hungarian Supreme Court, which had to rule on the discriminatory nature of the Hungarian legislation.[23] In its judgment, the Supreme Court held that the distinction between taxpayers belonging to a group of retail businesses and those not belonging to a group of retail businesses is clearly not direct discrimination, but indirect discrimination since it has the effect of placing legal entities linked to other companies within a group at a disadvantage. This statement stems from two specific features of the sectoral retail tax: firstly, the highly progressive tax rate at the top bracket and, secondly, the fact that the tax is based on the consolidated, i.e. notional turnover of all companies affiliated with the group.[24] Thus, the decision of the Hungarian court of first instance, taking into account the result of

21 Opinion of advocate general Juliane Kokott, Case C385/12, ECLI:EU:C:2013:531.

22 Group taxpayers were taxed on the basis of "fictitious turnover".

23 EH 2016.01.K3 The procedure to be followed on the grounds of the EU incompatibility of the tax base aggregation rule in Section 7 of the Special Tax Act [Különadó tv. 7. §; 2003. évi XCII. tv. 124/B. §].

24 Act XCIV of 2010 on the special tax on certain sectors 7. §.

the preliminary ruling procedure, is correct, as the Hungarian legislation was more disadvantageous for Hungarian subsidiaries of international companies. The Hungarian Supreme Court also rejected the defendant's request for a new preliminary ruling, on the grounds that, first, it is not obliged to refer every case to the CJEU and, second, the most important limitation on the questions to be asked is that they cannot search for an answer which the CJEU does not have jurisdiction to give.

Of note, in a subsequent case, Portugal v. Commission, the CJEU also established that the entire territory of a Member State should not always be taken as a benchmark when assessing selectivity.[25] The latter decision confirmed the fiscal sovereignty of the Member States and autonomous regions.

After the Hervis case, several foreign affiliates tried to take advantage of the ruling, but some of them were disappointed, as there were cases where the Hungarian Supreme Court did not find that there was discrimination.[26] In one case, the Hungarian court found that there was no discrimination against a Hungarian subsidiary of an Australian company. This is because the legislation does not generally require the net turnover of affiliated companies to be aggregated unless the affiliated company is also subject to the sectoral special tax. The performance of the foreign parent companies involved in the case was outside the scope of the special tax. Therefore, in this case, it was irrelevant whether each special taxable entity had a foreign parent company which could not be considered a special taxable entity. The CJEU did not say in general that the Hungarian special tax law is contrary to EU law, but that indirect discrimination may occur if the existence of a foreign affiliated taxpayer increases the tax base and consequently the tax burden of the taxpayer. The latter is always a matter for the national court to decide.

There was also a case pending before the Hungarian Supreme Court concerning a special tax on the telecommunications market, in which the institution rejected the reference to the Hervis case because it concerned

25 CJEU Judgment of 6 September 2006, February 2014, Portuguese Republic v. Commission of the European Communities, Case C-88/03, ECLI:EU:C:2006:511.

26 The Hungarian Supreme Court Kfv.35.010/2018/11.

the regulation of a special tax on retail sales in shops, which is a different type of taxation, a banded tax burden based on turnover.[27]

A few years later, however, another Hungarian decision was brought before the CJEU, requesting a discriminatory assessment of the retail sales tax. Some retail businesses (e.g. Tesco, Lidl, Penny Market) typically operate through a foreign-owned domestic company carrying out its retail activities through a number of branches scattered throughout the country. While these companies are not covered by the Hervis ruling (as they are not affiliated companies), they are disadvantaged compared to the franchise companies operating in Hungary (e.g. Coop, Reál) as a result of the Hungarian special tax law. Tesco's case was referred to the CJEU for a preliminary ruling, in which the commercial company challenged the compatibility with EU law of the sectoral special tax imposed on it for the financial years 2010–2012 before the Administrative and Labour Court of Budapest.[28] Tesco raised the issue of state aid, as companies operating in franchise form – mainly Hungarian – received a significant discount, which distorts competition. It argued that the tax legislation infringes the freedom of establishment, the principle of equality, constitutes prohibited state aid and is contrary to Article 401 of the VAT Directive.[29] On the latter claim, the national court did not ask the CJEU a question.

According to the Advocate General in the case, there was no overt or direct discrimination, since it is true that the progressive tax treats businesses with higher turnover differently from those with lower turnover, but the rules for levying the special tax do not discriminate according to the place of establishment or origin of the business. Furthermore, there was no obstacle to Tesco adapting its organizational structure to the changed tax circumstances. The Hungarian sectoral special tax is not targeted at foreign companies, but at multinational companies that operate internationally and across borders and seek to ensure that profits are taxed as little

27 The Hungarian Supreme Court Kfv.35.250/2016/7.

28 CJEU Judgment of 3 March 2020, Tesco-Global Áruházak Zrt. V. NTC, Case C-323/18, ECLI:EU:C:2020:140.

29 Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (O.J.E.C. L347, 11 December 2006), 1–118.

as possible. Fundamental freedoms do not require Member States to tax independently of the legal form.[30]

The CJEU is not bound by what is stated in the Advocate General's Opinion, but in this case, it has also followed the arguments set out in the Opinion. In a departure from the Hervis case, the Court held that the principle of freedom of establishment was not infringed because there was no discrimination simply because foreign companies were more heavily penalized.[31] Furthermore, there is no indirect discrimination and therefore no prohibited state aid. Also, according to the CJEU, persons subject to compulsory payment cannot rely on the fact that the exemption granted to other persons constitutes state aid in order to exempt themselves from payment.[32]

However, there is a case law of the CJEU where it has been held that there is a possibility that the same state intervention may constitute both a tax and an aid measure. In such cases, taxpayers may – if that is proven – be able to obtain a refund of the tax that constitutes (prohibited) state aid.[33] If the measure is presumed to be state aid, the national court is obliged to grant "legal certainty" to the legal entities.[34]

The Hervis and Tesco cases also show that the practice of the CJEU is not consistent and that the crises have led to a wider intervention of Member States in the market, coupled with a permissive attitude of the EU.

It is interesting to note that, in essentially similar circumstances, the Hervis case violates Hungarian law, while the Tesco case does not. The fact is that the greatest difficulty in the EU's examination of Member State rules on progressive special taxes is that tax policy is a Member State competence, in which it cannot directly intervene. If, however, a Member State's measure is deemed to constitute prohibited state aid, this also means that

30 Opinion of Advocate General Juliane Kokott in Case C 323/18. [ECLI:EU:C:2019:567.].

31 Case C-323/18, 72 and 76.

32 CJEU Judgment of 29 April 2021, I.W. and R.W. v. Bank BPH S.A., Case C-390/98, ECLI:EU:C:2001:456, 80.

33 CJEU Judgment of 7 September 2006, Laboratoires Boiron SA., Case C-526/04, ECLI:EU:C:2006:528.

34 CJEU Judgment of 21 November 2013, Deutsche Lufthansa AG v. Flughafen Frankfurt-Hahn GmbH, Case C-248/12, ECLI: EU:C:2013:755, 30 and 45.

a broader interpretation of the concept of state aid prevails, while the principle of fiscal sovereignty is pushed to the background.[35]

It is also important for the distinction between state aid and tax provisions that the assessment of the compatibility of aid measures with EU law (the internal market) is the exclusive competence of the European Commission,[36] while tax policy is the competence of the Member States. In the latter case, the EU institutions only have competence if a measure is both aid and a tax measure.

3.3. Tax or State Aid?

In the Hervis case, the CJEU did not deal with the separation of the state aid and tax issue (as it was not part of the reference for a preliminary ruling), whereas in the Tesco case, the CJEU only dealt with the tax and state aid issues in a tangential manner. But the question arises: what if the state intervention is both tax and state aid?[37]

In one of the cases before the Hungarian Supreme Court, the plaintiff sought an injunction against the application of the Hungarian special tax law[38] on the ground that it constituted State aid under Article 107 TFEU. According to the facts of the main case, the applicant submitted a self-assessment to the National Tax and Customs Office (NTC) in 2011, in which it stated that it had not incurred a special tax on retail trade in 2010.

Following the NTC's refusal and the decision of the Supreme Court in a similar case,[39] the plaintiff initiated an administrative lawsuit. It claimed that the special shop-retail tax is, *inter alia*, discriminatory, contrary to Articles 49 and 54 TFEU and constitutes prohibited State aid.

The Administrative and Labour Court of Veszprém suspended the proceedings pending before the CJEU in the Tesco case C-323/18 until the final conclusion of the preliminary ruling proceedings. However, as a result of the aforementioned Tesco ruling, the Veszprém court dismissed

35 Dóra Lovas, "Az Európai Unió Bíróságának energiaszektort érintő gyakorlata az EUMSZ 107. cikk (1) bekezdés fogalmi elemeinek vonatkozásában," *Kúriai Döntések–Bírósági Határozatok*, no. 11 (2021): 1743–50.

36 Case C-248/12, 28.

37 Case C-526/04.

38 Act XCIV of 2010 on the special tax on certain sectors.

39 The Hungarian Supreme Court Kfv.I.35.116/2015/8.

the plaintiff's claim, finding that the Hungarian legislation does not constitute prohibited state aid in the present case. As regards the nature of the prohibited State aid alleged by the applicant in relation to the special levy, the CJEU has already ruled on several occasions that taxes do not fall within the scope of its state aid provisions unless they form an integral part of them. In order for a tax to be considered an integral part of an aid measure, there must be a compulsory link between the tax and the aid under the relevant national legislation, that is to say, the tax revenue must be used to cover the aid, which thus directly affects the amount of the aid.[40]

The case was subsequently referred for review to the Supreme Court, which also rejected the plaintiff's request for a refund of the tax paid. The applicant relied on the Barion case, where the CJEU held that the same measure constituted both tax and aid and ordered the recovery of the subsidy. However, the Hungarian Supreme Court pointed out that the present case was fairly different since the French case did not concern a tax of general application, but the scope of the tax was determined for a category of undertakings (retailers) and the State aid resulted from the exemption of direct competitors from the payment of the tax.[30] In the Barion case, the obligation to pay contributions and the alleged aid measure were two inseparable parts of the same tax measure.[31] Thus, in cases such as the French one, it is possible to claim reimbursement of the amount paid if it is shown that it results in overcompensation of another category of undertakings.[32] The presented Hungarian case was different, as the retail tax is general and the payment obligation was imposed on competing businesses engaged in the same activity, namely retail sales in shops.

The Supreme Court also rejected the applicant's application for legal protection.[33] Here, the applicant referred to the Lufthansa judgment, where Lufthansa, as a competitor, brought an action to recover payments made to another competing airline, Ryanair, and to prohibit future payments, alleging that there was prohibited State aid.[34] In the German case, the state measure constituted aid as it was selective and it only had to be assessed whether it was permissible under the private investor principle. The procedure was suspended pending the judgment of the CJEU, which also took

[40] CJEU Judgment of 15 June 2006, Air Liquide Industries Belgium, Case C 393/04 and C 41/05, EU:C:2006:403, 46; Case C 526/04, 44.

into account the formal investigation procedure opened before the European Commission and the fact that the case concerned aid measures already benefiting Ryanair. The German case focused on the preventive objective until a final Commission decision would remove the doubts.

It should also be stressed that the Supreme Court is not obliged to refer a case to the European Commission if it has doubts as to whether the case constitutes State aid and has the possibility to request a preliminary ruling from the CJEU. In the Hungarian case pending at that time, the court of first instance suspended the proceedings in view of the preliminary ruling procedures already initiated before the CJEU, awaited the outcome of those procedures and made its decision in the light of the C-323/18 judgment. The Hungarian Supreme Court, therefore, did not identify any procedural obligation similar to those in the Bairon or Lufthansa judgments and therefore did not have to take any action on recovery or preservation of rights.

Those cases have been highlighted because of the link between tax and state aid. However, as regards Hungarian special taxes, not many cases have reached the Hungarian Supreme Court, while the CJEU has on several occasions declared Hungarian special tax rules to be in conformity with the EU.[41]

4. Retail Sales Tax from 2020 to Date

From 2020 to the present, two interlocking crises (the COVID-19 pandemic and the energy crisis caused by the Russian-Ukrainian war) have brought a new economic crisis for European countries.[42] This period has been characterized by shortages of supply in certain sectors, high inflation[43] and a fall in investment, with some market segments accumulating significant profits. To tackle the crisis, the Government has reintroduced special taxes on sectors and market players that have strengthened their position during

41 Darák and Lovas, "Az adórendszer deszantosai: a különadók," 481–91.

42 From 2020 to the present, Hungary is in a state of emergency. During a state of emergency, the Fundamental Law provides the possibility for the Government to regulate by decree matters that would normally only be regulated by law by Parliament.

43 According to the data of the Hungarian Central Statistical Office (KSH), it was 5.1% in 2021 and 14.5% in 2022. Source: "Factsheet," KSH, accessed March 1, 2024, https://www.ksh.hu/gyorstajekoztatok/#/hu/list/far.

the crisis. The post-2020 period of special taxes has a number of specific features. First, they will burden many more sectors than in previous crises.[44]

Furthermore, according to the legislation, the new special taxes have been levied as an additional tax burden on top of the existing sectoral special taxes, for a transitional period, and most of them have been regulated as a special tax, so that they constitute the revenue of two financial funds, the Energy recycling fundand National Defence Fund (except for the retail tax and the advertising tax). As extra-profit taxes, these special taxes are intended to tax the excess profits above the average profits of companies resulting from the crisis but also serve other governmental objectives.

It is a legislative peculiarity that the Government could regulate these special taxes in a Government Decree, referring to the exceptional situation in force since 26 March 2020, so the Parliament did not regulate the special taxes at the statutory (guarantee) level.[45] Another common feature is that, with the exception of the additional retail sales tax, they were originally planned to be levied for two tax years (2022 and 2023), but the prolongation of the energy and economic crisis and the suspension of EU development and recovery aid made it necessary to extend the special taxes until the end of the 2024 tax year. These extra profit taxes were levied during the year, already on business profits for the tax year, raising the problem of the prohibition of retroactivity.[46]

The above taxes, in particular their temporary nature and their target tax regime, are in line with EU regulation 1854/2022/EU, but the question is whether they are indeed a charge on the extra profit attributable to the crisis. It can be concluded that these are basically sectors that have made profits as a result of the COVID-19 epidemic and/or the Russian-Ukrainian conflict. Although their profits mostly result from the crisis, the tax does

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44 The Government introduced "extra-profit taxes" covering eight sectors (banking, insurance, energy, retail, telecommunications, air transport, pharmaceuticals and advertising) by Government Decree 197/2022 (4.VI.), as amended several times since then, which entered into force on July 1, 2022.

45 "The legislative process," European Parliament, accessed March 1, 2024, https://www.parlament.hu/documents/10181/62157/T%C3%B6rv%C3%A9nyalkot%C3%A1si+folyamat%C3%A1bra+0509javitott/1600b677-8e26-4362-b1a0-b3f8ea8d92de?version=1.0&inheritRedirect=true.

46 Act CXCIV of 2011 on the Economic Stability of Hungary 31. § (1).

not necessarily tax the excess profits over netto or average returns. In most cases, the original legislation was based on annual turnover.[47]

The majority of the new special taxes are not entirely new, as for example, a special tax was already levied on shop retailing between 2010 and 2012.[48] After the transitional period from 2010 to 2012, a retail sales tax was introduced in 2020, essentially a counterpart of the previous special retail sales tax. The retail sales tax was the subject of considerable controversy between 2010 and 2012, but the changed, more permissive attitude of the CJEU in the Tesco case allowed its reintroduction (see above). The special levy introduced in response to the COVID-19 epidemic was triggered by the pandemic and became a tax targeted on one of the funds used to manage it between 2020 and 2021. However, it ceased to be a targeted tax in 2022 (when the pandemic ended).

Under the emergency legislation, it was first regulated by a Government Decree,[49] then enshrined in law, and tax revenue remained part of the tax system after the epidemic. The activities covered by the retail sales tax are the same as those covered by the 2010 special tax,[50] but with the restriction that only retail activities where the customer is the final consumer are taxable. In both cases, the tax is based on the net turnover of the retail activity and the tax rate is progressive in bands. However, between 2022 and 2024, Decree 197/2022 increased the retail tax rate for all taxable turnover bands, with higher rates for 2023 and 2024. In addition to introducing the retail sales tax in 2020 and its increase from 2022 onwards, a retail sales tax surcharge was introduced for the 2022 tax year only, which was 80% of the retail sales tax payable in 2021.

In 2024, however, the Spar supermarket took a new turn: it turned to the European Commission, claiming that the Hungarian retail tax (price freeze and other distortive measures) was making it impossible for

47 Except air transport contribution.

48 Act XCIV of 2010 on the special tax on certain sectors.

49 In order to implement the Economic Protection Action Plan, Government Decree 109/2020 (IV. 14.) on the retail sales tax to replenish the Epidemic Fund was in force from May 1, 2020 to June 9, 2020, and the rules of the retail sales tax were laid down in Act XLV of 2020 on the retail sales tax.

50 Excluding wholesale of motor vehicles, trailers and semi-trailers and repair and sale of motorcycles.

the group to operate profitably in Hungary.[51] In addition to the European Commission's preliminary investigation into the retail sector, the European Parliament's Committee on Budgetary Control's examination of Hungary under the rule of law conditionality (a special retail tax scheme too) could lead to interesting results.

The retail sector has been under significant strain since the recession caused by the COVID-19 pandemic in 2020. One of these burdens (mostly on grocery stores) were price controls that were in force for more than a year. Price controls are a common form of public intervention, sometimes encouraged by the EU (e.g. for services of general economic interest important to society) or applied by it (e.g. roaming charges). However, the food and fuel price freeze introduced in Hungary is a unique and more drastic intervention in market conditions than its predecessors. This may be due to the increasingly rapid succession of crises and subsequent recessions, which encourage states to learn from each other in order to avoid their previous wrong decisions, allocating new solutions from the toolbox of state intervention. The price freeze has been lifted, but the crisis is still ongoing. As the state keeps corporate taxes extremely low, it tries to replace them with other sources of revenue. This is why special taxes have become an integral part of the tax system, but their phasing out is difficult, as the Hungarian budget deficit is increasing year on year, while the EU withholds funds on rule of law grounds.

5. Conclusion

The challenges of the last decade and a half have led to several extraordinary government interventions, whereby special taxes have become part of the tax system again. One of the major problems with the transitional sectoral special tax on shop retailing is that it is easy to introduce but difficult to supplement. The slow economic growth expected in the coming years will not provide sufficient resources to do this. However, if special taxes become permanent, they will have growing economic disadvantages over time, such

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[51] "Spar supermarket accuses Hungary's Viktor Orbán over retail tax," Financial Times, accessed March 15, 2024, https://www.ft.com/content/32d0d2be-d530-4708-ad8f-dc02ea410504; "Letter from spar to its employees in Hungary," Spar, accessed March 29, 2024, https://www.penzcentrum.hu/vasarlas/20240326/megszereztuk-a-spar-titkos-levelet-ezt-uzentek-a-kormany-haduzenete-utan-a-magyar-dolgozoknak-1148708.

as a lack of investment. The disadvantages are compounded by the rapid introduction of taxes and frequent changes to tax rules, and an uncertain tax system also discourages foreign investment.

The crises (the economic crisis of 2008, the refugee crisis of 2015, the COVID-19 crisis of 2020 and the recession caused by the Russian-Ukrainian war) have led to an increase in the degree and extent of state intervention in EU Member States, coupled with a permissive attitude of the European Union.[52] This is supported by the divergent judgments in the two cases analyzed in the study, which are similar in many respects, since while in the Hervis case, the Court found that the retail sales tax infringed the freedom of establishment, in the Tesco case in 2019, it found that the national measure was likely to be compatible with EU law.[53] In the latter case, not only did it find no breach of the principle of freedom of establishment, but also no State aid problem, and thus no distortion of competition that would provide a significant advantage for competitors.

The extent to which special taxes contribute to the long-term sustainability of the budget raises interesting questions. The state has to deal not only with the current problems, but also with the consequences of the recession, which will increase budget expenditure, leading to an increasing need for special taxes. To compensate for the effects of the COVID-19 epidemic in 2020, Hungary has chosen not to raise existing headline taxes (the governmet not increase in corporation tax) but to intervene more in the market economy (by means of price freezes, special taxes etc.) through certain sectors. However, these interventions can only yield positive results temporarily, while in the long run, the results of the introduction of special taxes are difficult to estimate unless they are permanently incorporated into the tax system.

It also appears that the retail sales tax has other legal policy objectives besides crisis management (e.g. property reorganization), yet the CJEU has

52 M. Tamás Horváth, Ildikó Bartha, and Dóra Lovas, "Mikor kakukktojás? Állami vállalattulajdon az energia- és nyersanyagpiacon," *Közjogi Szemle* 15, no. 3 (2022): 22–34; M. Tamás Horváth, Ildikó Bartha, and Dóra Lovas, "A látható kéz -Támogatáselosztási jog válságok idején," *Magyar Jog*, no. 7–8 (2023): 459–70.

53 The position taken in the Tesco case was confirmed by the Court of Justice in its judgment in 2021, where the case concerned the Polish retail tax. CJEU Judgment of 16 March 2021, European Commission v. Republic of Poland, Case C562/19, ECLI:EU:C:2021:201.

not been consistent in its approach to the issue. It would be worth considering aspects such as the fact that these sectoral taxes are not temporary and account for a significant share of tax revenues (they are higher than the revenues from the sectoral corporate tax).

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A Critical Analysis of Selected Aspects of Real Estate Taxation in the Context of Recent Legislative Amendments in the Czech Republic

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tax base,
correction elements

Abstract: The real estate tax is the sole property tax in the Czech Republic and has been part of its tax system since its establishment, i.e. since January 1, 1993. The Czech Republic has long been recommended by the Organisation for Economic Co-operation and Development (OECD) to increase the collection of this tax because its yield as a share of gross domestic product (GDP) is one of the lowest among all OECD and EU countries. The lower yield is in part attributable to the manner in which the tax base is determined. The Czech Republic, with the exception of a few minor instances, continues to employ the assessment-based rather than the value-based method of determining the tax base. Furthermore, the Czech Republic is encouraged to use the correction elements at the disposal of municipalities to influence the amount of property tax. This article examines the revenue aspect of real estate tax in the Czech Republic, including the determination of the tax base and the use of correction mechanisms. In light of these considerations, it is evident that the development of the Czech real estate tax system has been influenced by a number of factors, including the introduction of one of the most significant amendments to the Real Estate Tax Act in the country's history. This amendment, known as the consolidation package, was implemented on January 1, 2024 and has had a profound impact on the current legislation.

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1. Introduction

One of the property taxes that is imposed on the basis of ownership is the real estate tax. Unlike other property taxes, the real estate tax is not dependent on the taxpayer's income.[1] This classification is in accordance with the OECD Classification of Taxes, Group 4000, Subgroup 4100.[2]

In the Czech Republic, as in other EU Member States, real estate tax represents a source of revenues for municipalities.[3] In the Czech Republic, the only tax in the tax system, from which all proceeds are allocated to the budget of the municipality, in which the immovable property is located.[4] The term "real estate tax" encompasses two distinct types of taxation: that levied on land, and that applied to buildings and units.

In the Czech legal system, the real estate tax is regulated by Act No. 338/1992 Coll. on the Real Estate Tax (hereinafter also referred to as "ZDNV"). Since 1993, the real estate tax legislation has been amended on approximately 40 occasions, particularly in response to the need to address current issues and to reflect the decision-making practice of the courts of the Czech Republic. Following the enactment of Act No. 349/2023, which amends various laws in connection with the consolidation of public budgets (hereinafter referred to as the "consolidation package"), the real estate tax has undergone one of the most significant amendments in its history, encompassing approximately 40 points of amendment.

In the case of the Czech Republic, the yield of this tax in relation to gross domestic product (GDP) is one of the lowest in international comparison, according to statistics published by the OECD and the European Commission.[5] As Radvan notes, in contrast, the Anglo-Saxon countries,

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1 Michal Radvan, *Místní daně* (Praha: Wolters Kluwer Česká republika, 2012), 146.

2 Břetislav Andrlík and Lucie Formanová, "Importance of the Recurrent Tax on Immovable Property in the Tax Systems of EU Countries," *Acta Universitatis Agriculturae et Silviculturae Mendelianae Brunensis* 62, no. 6 (Jan 2014): 1213–20.

3 Alena Vančurová and Hana Zídková, *Daňový systém ČR 2022* (Praha: Wolters Kluwer, 2022), 323.

4 Section 4 item 1a) Act on budgetary determination of selected taxes of the municipalities and selected state funds (Act on budgetary determination) of 9 August 2000, Journal of Laws of 2000, No. 243, as amended.

5 "Taxation trend indicators table (Table 75: Taxes on property as % of GDP – Recurrent taxes on immovable property)," European Commission, accessed May 1, 2024, https://taxation-customs.ec.europa.eu/taxation-1/economic-analysis-taxation/annual-report-taxation_en;

the USA and the United Kingdom are characterized by a considerable proportion of this tax in municipal budgets.[6] According to the OECD statistics, the real estate tax yield for 2021 in both the USA and the United Kingdom is just over 2.5% of GDP. Overall, property taxation constituted 3.1% of GDP in the USA and 3.9% of GDP in the United Kingdom in the same year.[7]

In addition to the relatively low yield of this tax in the Czech Republic, the OECD has also identified issues with the construction of the tax base and the limited use of correction elements under the Real Estate Tax Act.[8]

The objective of this article is to examine and evaluate three elements of the real estate tax in the Czech Republic: the yield of taxation, the setting of the tax base, and the use of corrective elements. These elements are analyzed with reference to their development and the current legislative framework, taking into account the changes introduced by the breakthrough consolidation package.

2. Methodology

The author employs primarily scientific methods of analysis and synthesis. The descriptive approach is used to examine the selected area, particularly in relation to tax base legislation and correction elements.

Secondary research on the topic has been conducted by the author, who has incorporated sources such as published studies, articles, monographs, databases, and online sources to obtain pertinent information for the chosen topic. With regard to this foundation of the chosen topic, it can be considered sufficient within the Czech legal framework.

The primary source of information on the budgetary significance was the data obtained from MONITOR – State Treasury, a specialized information portal of the Ministry of Finance, which allows the public free access to budget and accounting information from all levels of state and

"OECD Economic Surveys: Czech Republic 2023," OECD Publishing, accessed May 1, 2024, https://doi.org/10.1787/e392e937-en.

6 Michal Radvan, *Zdanění majetku v Evropě* (Praha: C.H. Beck, 2007), 34.

7 "Global Revenue Statistics Database", OECD, accessed May 1, 2024, https://www.oecd.org/tax/tax-policy/global-revenue-statistics-database.htm.

8 OECD, "OECD Economic Surveys: Czech Republic 2023".

local government, as well as from the state final accounts of the Czech Republic, the official websites of the European Commission and the OECD.

In order to conduct an analysis of the tax yield, it is necessary to employ basic methods of descriptive statistics, which include determining the average and median values, as well as calculating absolute growth, relative growth, the growth coefficient and the average growth coefficient.

Some Czech authors have identified an increasing confrontation between lawyers and statistics, and have highlighted the necessity for lawyers to be prepared to work with them. In some countries, legal research is conceptualized as a complex science, characterized by the use of graphs, figures and statistics, as is the case in the USA. Such research may not only entail the search for causal relationships, but may also be purely descriptive, utilizing basic descriptive statistics, graphs and correlations.[9]

In order to enhance the clarity of the presentation, tables and bar charts have been included for some of the conclusions.

3. Research and Results

3.1. The Budgetary Significance of the Real Estate Tax in the Czech Republic Between 2013 and 2023

In the Czech Republic, local governments do not collect their own taxes. The only tax for which municipalities may influence the amount of its revenues and which is destined only for their budget is the real estate tax. The following figure illustrates the Czech Republic's collection of this tax in comparison to other EU countries, according to the most recent data available for 2022.

[9] Libor Dušek and Josef Montag, "Ekonomický přístup ke zkoumání práva: přehled metodologie a nástin příležitostí pro výzkum v České republice," *Jurisprudence* 25, no. 6 (2016): 39–48; Hubert Smekal and Katarína Šipulová, "Empirický právní výzkum," *Jurisprudence* 25, no. 6 (2016): 31–8; Michal Bobek, "Výzkum v právu: reklama na Nike anebo kvantová fyzika?," *Jurisprudence* 25, no. 6 (2016): 3–10.

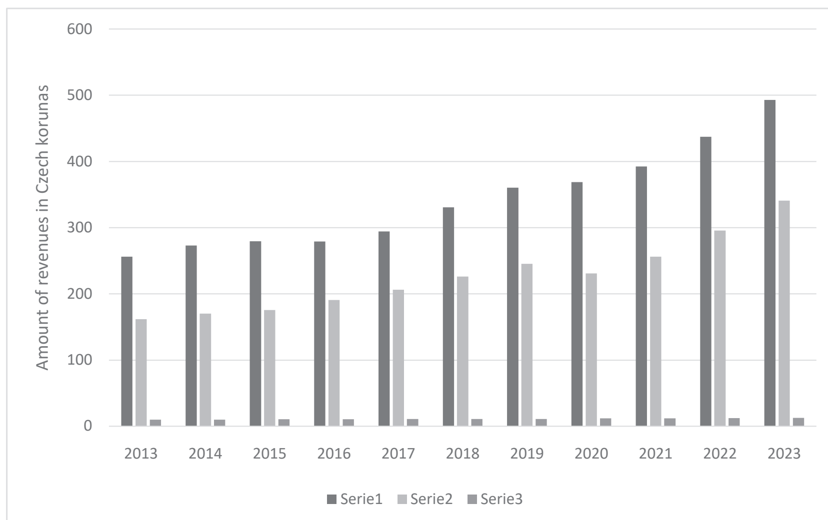

Figure 1. Taxes on immovable property as % of GDP – 2022 (own study according to source from the European Commission, DG Taxation and Customs Union).

The preceding Figure 1 shows that the Czech Republic is in the first quartile of EU countries (the threshold is 0.3) with the lowest real estate tax yield relative to GDP.[10] A comparison of the tax yield relative to GDP of the Visegrad Four countries with that of the Czech Republic indicates that all three other countries have a higher tax yield than the Czech Republic. Hungary is only slightly higher at 0.3, while Slovakia is at 0.4. Nevertheless, Poland, with its current yield of approximately 1% of GDP, is already approaching the average of both the EU and OECD Member States.

According to the Figure 1, Greece and France have the highest yields, which correspond to approximately twice the average yield of both the EU and OECD. According to the European Commission statistics, the Czech Republic's property tax yield remained at approximately 0.2% of GDP between 2013 and 2023.[11]

10 Tereza Košťáková, *O složitém jednoduše, aneb, Nebojte se statistiky, nekouše* (Praha: Český statistický úřad, 2019), 54.

11 "Summary tables by countries. European Commission," European Commission, accessed May 1, 2024, https://taxation-customs.ec.europa.eu/taxation/economic-analysis-taxation/annual-report-taxation_en.

The following table and figure illustrate the development of real estate tax collection in the Czech Republic between 2013 and 2023.

Table 1. Development of real estate tax collection in the Czech Republic from 2013 to 2023, expressed in billions of Czech korunas (CZK)

2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
9,736	9,925	10,423	10,574	10,713	10,761	10,849	11,654	11,847	12,262	12,467

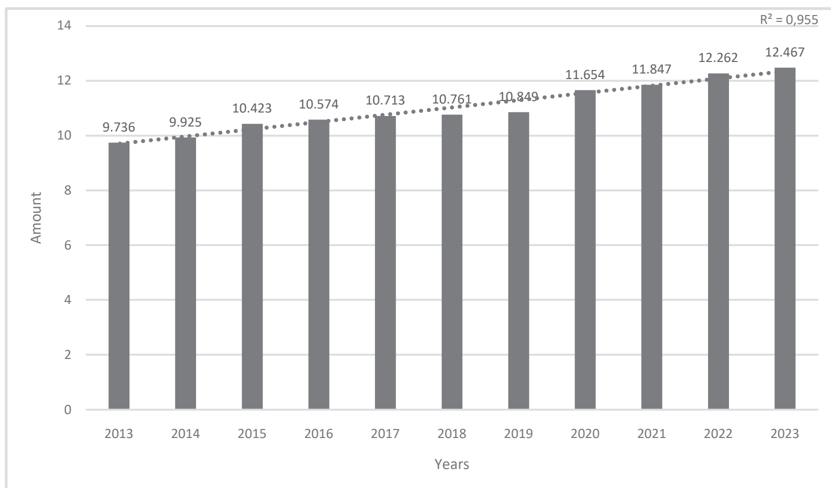

Figure 2. Development of real estate tax collection in the Czech Republic from 2013 to 2023, expressed in billions of Czech korunas (CZK) (own study according to source from MONITOR – State Treasury).

Figure 2 illustrates a consistent and sustained increase in real estate tax collection over the specified period. Figure 2 also shows the trend line, which is linear in the case of the development of the collection of this tax. It can be observed that the value of R^2, which represents the reliability of the trend, is 0.9559, which is already very close to 1. The trend

line is more reliable the closer its value is to 1.[12] A linear trend line typically indicates a consistent and progressive growth trajectory. This is also evident in the case of the development of real estate tax collections in the Czech Republic.

Two measures of the mean were derived from Table 1 and Figure 2. The author selected the arithmetic mean, supplemented with the standard deviation and the median, as measures of the mean. The measures of the mean indicate the location of the distribution of variables, expressing the approximate value of the mean. The standard deviation is then a measure of statistical variability, often used in statistics, where it is the quadratic mean of the deviations of the trait values from their arithmetic mean. The median then divides the sample into two equal halves, with 50% of the values being less than the median, and 50% of the values being greater than the median.[13]

The application of these measures of mean values indicates that the average size of the real estate tax collection over the past decade in the Czech Republic was CZK 11,019 billion. It is inadvisable to rely on an indication of the mean in isolation, without also considering the variability of trait values.[14] The standard deviation, CZK 0,912 billion, provides insight into the degree of concentration (or dispersion) of individual values around the mean value.[15] The median is equivalent to tax revenues of $10,761 billion in 2018, as observed in our sample.

The author then proceeded to investigate the growth dynamics of real estate tax collection. The dynamics of time series can be characterized through a number of measures, which in turn allows for the formulation of criteria for modelling based on the basic tendencies observed in the data set.

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12 Jana Hančlová and Lubor Tvrdý, *Úvod do analýzy časových řad* (Ostrava: Ekonomická fakulta, VŠB – TU Ostrava, 2003), 13, accessed May 1, 2024, https://www.fd.cvut.cz/department/k611/PEDAGOG/VSM/7_AnalyzaCasRad.pdf.

13 Jiří Neubauer, Marek Sedlačík, and Oldřich Kříž, *Základy statistiky: aplikace v technických a ekonomických oborech* (Praha: Grada Publishing, 2021), 53.

14 Ladislav Rabušic, Petr Soukup, and Petr Mareš, *Statistická analýza sociálněvědních dat* (Brno: Masarykova univerzita, 2019), 114.

15 Vlastimil Chytrý, Petr Trahorsch, and Alena Nováková, *Vybrané kapitoly ze statistické analýzy empirických dat* (Ústí nad Labem: PF UJE, 2019), 23–4.

The absolute growth rate (Δy_t) represents the simplest measure of dynamics. This metric quantifies the extent to which the time series has evolved relative to the preceding observation. The calculation method is as follows.

$$\Delta y_t = y_t - y_{t-1},\ t = 2, 3..., n$$

where y_t – the value of the real estate tax revenues (tax imposed) in the year t, y_{t-1} – the value of the real estate tax revenues (tax imposed) in the year *t-1*.[16]

The relative increment (δ_t) is then calculated, which, when multiplied by 100 (δ_t %), defines the extent to which the value of the time series *t* has changed in comparison to time *t–1*. This provides insight into the growth rate.[17]

$$\delta_t = \frac{\Delta y_t}{y_{t-1}} = \frac{y_t - y_{t-1}}{y_{t-1}} = \frac{y_t}{y_{t-1}} - 1$$

The third measure of dynamics is the growth coefficient (k_t), which indicates the extent to which the time series has changed relative to the previous observation. If this coefficient is multiplied by one hundred, it indicates the percentage increase in the value at time *t* in comparison to the value at time *t–1*. The growth rate is sometimes used as a label for this coefficient.[18]

$$k_t = \frac{y_t}{y_{t-1}} \qquad t = 2, ..., T.$$

Finally, the average growth coefficient will be calculated, from which the average growth rate of real estate tax collection in the Czech Republic for the analyzed period will be derived. The average growth coefficient is calculated as the geometric mean of the individual coefficients.[19]

The following table presents the findings of the analysis of the growth dynamics of real estate tax collection.

[16] Josef Arlt, Markéta Arltová, and Eva Rublíková, *Analýza ekonomických časových řad s příklady* (Praha: Vysoká škola ekonomická, 2002), 14.

[17] Jan Hendl, *Základy matematiky, logiky a statistiky pro sociologii a ostatní společenské vědy v příkladech* (Praha: Karolinum, 2021), 304–21.

[18] Arlt, Arltová, and Rublíková, *Analýza ekonomických časových řad s příklady*, 15.

[19] Hančlová and Tvrdý, *Úvod do analýzy časových řad*, 13.

Table 2. Analysis of the dynamics of real estate tax collection in the Czech Republic from 2013 to 2023

Year	Yield	Δy_t	k_t	δ_t	δ_t (%)
2013	9,736	–	–	–	–
2014	9,925	0,189	1,019	0,019	1,941
2015	10,423	0,498	1,050	0,0502	5,018
2016	10,574	0,151	1,014	0,0145	1,449
2017	10,713	0,139	1,013	0,0131	1,315
2018	10,761	0,048	1,004	0,0045	0,448
2019	10,849	0,088	1,008	0,0082	0,818
2020	11,654	0,805	1,074	0,0742	7,420
2021	11,847	0,193	1,017	0,0166	1,656
2022	12,262	0,415	1,035	0,0350	3,503
2023	12,467	0,205	1,017	0,0167	1,672

Source: own study according to source from MONITOR – State Treasury

The average growth rate of real estate tax collection over the analyzed period is calculated as

$$\frac{\sqrt[10]{12{,}467}}{9{,}736},$$

which is 1.02503. This indicates that real estate tax collection grew by an average of 2.5% per year in the period between 2013 and 2023.

The preceding table demonstrates that the time series underwent the most significant change in absolute growth between 2019 and 2020, with an increase of CZK 0,805 billion. The growth rate derived from the growth rate coefficient for the aforementioned period is 7.4%. It can be concluded that the greatest increase in real estate tax collection occurred between 2019 and 2020. The subsequent period demonstrating a more pronounced increase in real estate tax was 2015, during which the collection grew by 5% compared to 2014.

Taxation represents a significant source of revenues for local governments, particularly municipalities. However, tax autonomy is constrained in the Czech Republic due to the fact that tax revenues are predominantly shared. The collection of real estate taxes represents a relatively minor

source of municipal revenues, ranking among the lowest in terms of overall municipal tax revenues. The following figure illustrates the ratio of real estate tax revenues to other types of tax revenues, based on data from 2023.

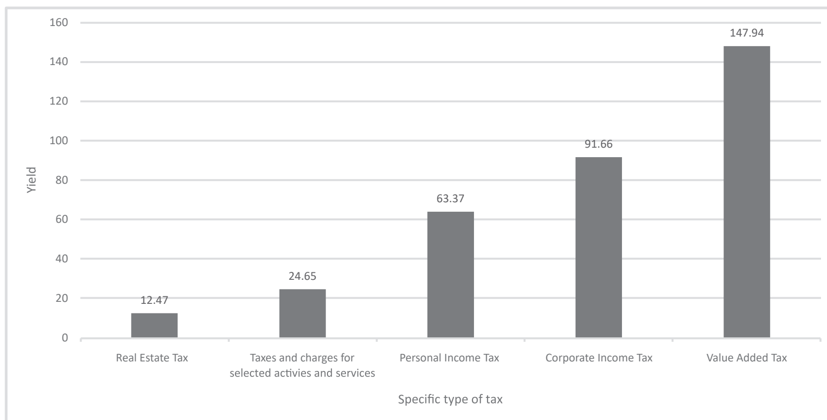

Figure 3. The municipal tax revenues for the year 2023, expressed in billions of Czech korunas (CZK) (own study according to source from MONITOR – State Treasury).

As illustrated in Figure 3, the municipalities' share of value added tax represents the dominant component of tax revenues.

The author notes that value added tax was the dominant tax throughout the analyzed period. The trends of corporate income tax and personal income tax were relatively balanced until 2017, with the latter being marginally lower than the former for several years afterwards. Nevertheless, as of 2021, the proportion of corporate income tax allocated to muni-Scipalities has already exceeded that of personal income tax. Throughout the period under analysis, taxes and fees on selected activities and services were collected at a higher rate than the real estate tax. It can be concluded that the real estate tax was the lowest tax revenues for municipalities in the long term.

The current tax legislation indicates that municipalities are entitled to a 24.92% share of value added tax (VAT), personal income tax and corporate income tax. During the analyzed period, there were several significant

changes in the budget allocation of taxes, which had a direct impact on the increase in tax revenue collection for municipalities.

In order to gain a comprehensive understanding of the data, it is necessary to consider the proportion of real estate tax in relation to total municipal revenues and tax revenues in the period under analysis. This is illustrated in Figure 4.

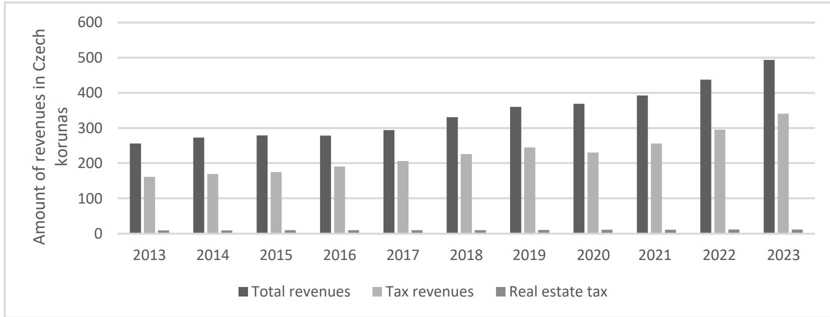

Figure 4. Ratio of total municipal revenues and tax revenues to real estate tax revenues in 2013–2023 in billions CZK (own study according to source from MONITOR – State Treasury).

Table 3. Ratio of total municipal revenues and tax revenues to real estate tax revenues in 2013–2023 in billions CZK.

Income / Years	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total revenues	256,18	272,91	279,45	278,95	294,24	330,86	360,46	368,98	392,4	437,48	493,06
Tax reveues	161,73	170,09	175,39	190,75	206,32	226,22	245,2	230,85	256,01	295,64	340,69
Real estate tax	9,736	9,925	10,423	10,574	10,713	10,761	10,849	11,654	11,847	12,262	12,467

Source: own study according to source from MONITOR - State Treasury.

Figure 4 and Table 3 demonstrate that total revenues and tax revenues grew at a faster rate than real estate tax collections during the analyzed period. In 2020, tax revenues declined by 5.8%. This decline was primarily attributed to an 18.1% reduction in corporate income tax and

a 5.7% decrease in personal income tax. However, this decline was offset by a one-off contribution of CZK 1,250 per capita provided by municipalities to mitigate the impact of the payment of a compensation bonus to entrepreneurs. Consequently, the overall impact of the "corona crisis" on municipalities in terms of tax revenues was minimal.[20]

Figure 4 and Table 3 indicate that tax revenues constituted, on average, 66.17% of total municipal revenues over the period under consideration. The majority of this amount was derived from the share of the shared taxes.

3.2. The Tax Base for Real Estate Tax

The tax base in Czech legislation is determined separately for land and in a different way for buildings.[21]

The tax base for agricultural land is the price of the land, which is calculated by multiplying the actual area of the land in square meters by the average price of land per square meter, as determined by a decree issued by the Ministry on the basis of statutory authorization. The tax base for forest land is the price of the land determined in accordance with the price regulations in force as at 1 January of the tax period, or alternatively, the product of the actual area of the land in square meters, and the amount of CZK 3.80. Finally, the tax base for other land, built-up areas and courtyards, building land and paved areas of land is the actual area of the land in square meters determined as at 1 January of the tax period.[22]

The above data makes it clear that for land, the price is only taken into account in the case of agricultural land. In this case, it is based on the creditworthiness of the land. Alternatively, it may also be based on law for economic forest land. In this case, the amount is fixed. In the case of agricultural land, the Annex to the Decree of the Ministry of Agriculture contains a list of cadastral territories with the assigned average basic prices of agricultural land registered in the Land Register in the land type of arable land, hop-growing areas, vineyards, gardens, orchards and permanent grassland. These prices are derived from the bonitated soil-ecological units

20 "Hospodaření územních rozpočtů v roce 2020," Deník veřejné správy, accessed May 1, 2024, https://www.dvs.cz/clanek.asp?id=6815788.

21 Petra Jánošíková and Petr Mrkývka, *Finanční a daňové právo* (Plzeň: Vydavatelství a nakladatelství Aleš Čeněk, 2016), 338.

22 Michal Krajňák, *Daň z nemovitých věcí v České republice* (Brno: CERM, 2024), 27–9.

of agricultural land. The average land price is determined individually for each cadastral area.[23]

The tax base for taxable buildings and units is defined as the area of the built-up area in square meters as at 1 January of the tax period. In the context of real estate tax, the built-up area is understood to be the built-up area of the building in accordance with the provisions set forth in the Building Act, which encompasses the above-ground portion of the taxable building. The basis for the tax on buildings and units is the adjusted floor area, which is the floor area of the taxable unit in square meters multiplied by a coefficient of 1.2 or 1.22, depending on the ownership of the land belonging to the unit. It is therefore evident that the tax base for buildings and units in the Czech Republic is not linked to the value of the immovable property.[24]

The consolidation package did not affect the way in which the tax base is determined in the Czech Republic. The author additionally notes that in previous years, legislative proposals have been put forth suggesting that the property tax be based on its value, for example in 2001, 2003, and 2012; however, these proposals were not adopted.

The consolidation package introduced a single amendment in relation to ponds used for intensive and industrial fish farming. These were excluded from taxation as a consequence of the consolidation package, and therefore are no longer included in the provisions governing the tax base. Consequently, with effect as of 2024, all water areas in the Czech Republic are no longer subject to taxation.

With regard to the determination of the tax base, the OECD recommends to the Czech Republic that the tax base should take into account the real and updated value of the immovable property, rather than the assessment of the immovable property, as is the case in Denmark, Estonia, Spain or the United Kingdom.[25]

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23 Monika Novotná and Petr Koubovský, *Zákon o dani z nemovitých věcí: komentář* (Praha: Wolters Kluwer, 2015), 28–9.

24 Jana Procházková, Věra Engelmanová, and Martin Mikuš, *Komentář k majetkovým daním a dani silniční s příklady: daň z nemovitých věcí, daň z nabytí nemovitých věcí, daň silniční* (Bohuňovice: Účetní-portál, 2019), 105–12.

25 OECD Publishing, "OECD Economic Surveys: Czech Republic 2023".

According to Radvan, the *ad valorem* tax base is a more widespread and also more modern method of taxation worldwide and, according to his research, most EU countries use this system. A significant number of authors have focused their attention on the comparison of the value and assessment base, presenting a detailed analysis of the advantages and disadvantages of both systems. Additionally, they have conducted a thorough examination of the situation in their respective countries, placing them in a broader international context.[26]

The author posts that the Czech Republic should consider implementing a change in the determination of the tax base as part of a broader legislative reform. However, the practical challenges associated with this transition, including the potential for increased administrative and financial complexity, must be carefully considered.

3.3. The Modification of the Corrective Elements through which Municipalities May Exert Influence over the Level of Taxation on Immovable Property

One of the most significant changes resulting from the consolidation package has been in the adjustment elements that municipalities may use to influence the property tax. As some municipalities are actively using these corrective elements, they will be required to revise their existing general binding ordinances in light of the legislative amendments and adopt new general binding ordinances corresponding to the text of the law for the tax period of the following year.

In the Czech Republic, municipalities have the option of implementing various correction mechanisms within the real estate tax system to adjust the final amount of the tax.

3.3.1. Coefficient by Population

This coefficient is referred to as the location rent and reflects the number of inhabitants in the municipality. It is employed solely in relation to certain

[26] See also: Marcin Burzec, "Koncepcje opodatkowania nieruchomości rolnych w wybranych krajach europejskich – wnioski dla Polski, Village and Agriculture (Wieś i Rolnictwo)," *Polish Academy of Sciences (IRWiR PAN), Institute of Rural and Agricultural Development* 169, no. 4 (2015): 77–89; Michal Głuszak, "On the Equity of the Area-Based Property Tax System in Poland," *World of Real Estate Journal (Swiat Nieruchomosci), Fundacja Uniwersytetu Ekonomicznego Krakow* 94, no. 4 (2015): 37–44; Anna Vartašová and Karolína Červená, *Views on Quality of Tax Regulation in the Slovak Republic* (Praha: Leges, 2019).

immovable properties. In accordance with the prevailing legislation, the municipality may, by means of a general binding decree, increase the coefficient by one category or decrease it by up to three categories. Given the limited applicability of this coefficient, the impact of adjustments to this coefficient on total tax revenues is relatively insignificant.[27]

On January 1, 2025, the consolidation package will fundamentally change this coefficient. This change will make it no longer possible to reduce it by one to three categories. However, it remains possible for municipalities to increase this coefficient.

3.3.2. Coefficient 1.5

In accordance with the prevailing legislation pertaining to buildings and units used for business purposes, those intended for family recreation, and garages, the municipality may also determine the coefficient 1.5. One disadvantage of this coefficient is that municipalities lack the ability to influence its size.[28]

Nevertheless, the abolition of this coefficient is scheduled for January 1, 2025, as a consequence of the consolidation package. Consequently, the general binding ordinances of the municipalities setting it will be applied for the final time in the 2024 tax year.

3.3.3. Local Coefficient

With effect as of January 1, 2025, there is a comprehensive legislative change to the regulation of the local coefficient, which is used to multiply the taxpayer's total tax liability.

In accordance with Section 12(1) of the ZDNV, a municipality may set the local coefficient of 0.5 to 5.0, to no more than one decimal place, by means of a generally binding decree for a municipality, individual cadastral area, urban district or individual urban district or individual group of immovable property. A further possibility is the introduction of a new form of general nature measure, issued by the municipal council, in the case of a local coefficient for specific immovable property.[29]

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27 Jana Janoušková and Šárka Sobotovičová, "Approaches to Real Estate Taxation in the Czech Republic and the EU Countries," *International Advances in Economic Research* 27, no. 1 (2021): 61–73.

28 Jana Janoušková and Šárka Sobotovičová, "Immovable Property Tax in The Czech Republic. As an Instrument of Fiscal Decentralization," *Technological And Economic Development of Economy* 22, no. 6 (2016): 767–82.

29 Ibid.

The preceding analysis leads to the conclusion that the new option to set the local coefficient at 0.5 effectively represents a reduction in the tax burden for real estate taxpayers by half.

A novel feature is the capacity for municipalities to determine the local coefficient ranging from 0.5 to 1.5 for selected agricultural land, permanent grassland, or other unusable areas. The concept of immovable property is no longer defined by reference to a map. In the event that immovable property is not duly marked in accordance with the relevant statutory provisions, it shall be deemed to be as if no local coefficient had been established for it.[30]

It is evident that the local coefficient under the revised legislation, as a consequence of the consolidation package, permits municipalities a greater degree of flexibility in its imposition. Previously exempt from its application, agricultural land is now subject to the local coefficient. Furthermore, the local coefficient can be imposed on a single immovable property, rather than in the form of a generally binding decree. Instead, it can be imposed by a measure of a general nature.

The author further notes that if the municipality decides to introduce the local coefficient in this manner, it will be necessary to exercise particular caution to ensure that the municipality's action can withstand scrutiny with regard to fairness and non-discrimination. Nevertheless, it is anticipated that some tax subjects will use all available defenses in the event of an increase in taxation on individual municipal properties, coupled with the development of case law that clarifies the limits of this new regulation. Furthermore, the municipality must consider the increased administrative complexity of the entire process, which was repeatedly highlighted by the Association of Local Authorities of the Czech Republic during the legislative process.[31]

In addition to the aforementioned coefficients, an inflation coefficient has been incorporated into the real estate tax legislation with effect as of the 2024 tax year onwards, based on the consolidation package. This

[30] "Změny v koeficientech u daně z nemovitých věcí na zdaňovací období roku 2025," Finanční správa ČR, accessed May 1, 2024, https://www.financnisprava.cz/cs/dane/dane/dan-z-nemovitych-veci/informace-stanoviska-a-sdeleni/2024/zmeny-v-koeficientech-u-dnv-2025.

[31] "Místní koeficient pro jednotlivé nemovitosti působí potíže. Jak na opatření obecné povahy?," Deník veřejné správy, accessed May 1, 2024, https://www.dvs.cz/clanek.asp?id=6962985.

coefficient is used to multiply the resulting tax on land and the resulting tax on buildings and units. Nevertheless, the municipality is unable to influence the amount or determination of the inflation coefficient. For agricultural land, the inflation coefficient is always 1.0, as inflation is already taken into account when determining the tax base for such land. The change in the inflation coefficient will be announced by the Ministry of Finance in the form of a notice published in the Collection of Laws and International Treaties by 30 June of the calendar year immediately preceding the tax year.

4. Discussion

The yield of real estate tax is contingent upon a multitude of variables, including the regulatory and investigative activities of the tax administration authorities. These authorities use the special system to identify undeclared or incorrectly declared land, taxable buildings, or units. Furthermore, tax collection is increasing as a consequence of the expansion in construction activity, the rising number of taxable buildings, taxable units and taxpayers.[32]

In addition to the aforementioned factors, the configuration of the individual components of the tax-law relationship, which include the tax subjects, the tax object (subject), the tax base and the tax rate, is of significant consequence for the tax yield. Some authors, such as Vančurová, include tax exemptions, deductions from the tax base or tax rebates among the fundamental elements of the taxes.[33]

The consolidation package has had a significant impact on property tax yields, in many ways. One of the most significant alterations was an 80% increase in the majority of rates. Another significant alteration is the modification of the coefficients that determine the final real estate tax amount. As a consequence of the consolidation package, one of the traditional coefficients, 1.5, has been abolished. In contrast, there has been considerable refinement and expansion of the options in relation to the local coefficient. The tax changes have resulted in the local coefficient becoming a fundamental correction mechanism that municipalities can use not only to increase, but even to decrease the resulting real estate tax,

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[32] Jana Procházková, *Komentář k dani z nemovitých věcí s příklady 2021* (Bohuňovice: Účetní Portál a.s., 2021), 12.

[33] Vančurová and Zídková, *Daňový systém ČR 2022*, 5.

including agricultural land. The local coefficient was first introduced into Czech legislation in 2009, and for the first time in 2010, only 389 municipalities decided to apply it. This year, 838 municipalities used the local coefficient, representing approximately 13.4% of all municipalities in the Czech Republic.[34]

The fundamental rationale for introducing this coefficient is fiscal. Furthermore, research indicates that municipalities frequently emulate one another and implement the coefficient in accordance with neighboring municipalities.[35]

One of the more contentious aspects of the consolidation package is the potential for linking the local coefficient to an individual immovable property by a general measure. This is a point that has already been highlighted in the aforementioned text. It is worth noting that the application of the local coefficient to an individual immovable property was considered by the Constitutional Court in 2023 under the legislation prior to the adoption of the consolidation package. In the case in question, the Ministry of the Interior invoked the repeal of the provisions of the general binding decree of the municipality, which imposed a local coefficient of 5 for parts of the municipality within the scope of the parcel numbers of the land according to the decree. In its decision, the Constitutional Court rejected the Ministry of the Interior's claim, holding that the municipality had issued the ordinance within the limits of its autonomous competence and had not abused its competence. The Court found that the municipality had pursued a legitimate aim and had used appropriate means to achieve it. The Constitutional Court held that the ability of municipalities to impose higher taxation on specific real estate met the constitutional principle of local government and the subsidiarity of political power.[36]

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[34] "Změny v koeficientech u daně z nemovitých věcí na zdaňovací období roku 2025," Finanční správa, accessed May 1, 2024, https://www.financnisprava.cz/cs/dane/dane/dan-z-nemovitych-veci/informace-stanoviska-a-sdeleni/2024/zmeny-v-koeficientech-u-dnv-2025.

[35] Jana Janoušková and Šárka Sobotovičová, "Property Tax in the Regions of the Czech Republic," *E+M Ekonomie a management* 20, no. 4 (2017): 120–34; Lucie Formanová, Martina Halamová, and Břetislav Andrlík, "Utilization of a Local Coefficient for Immovable Property Tax in the Czech Republic," *Acta Universitatis Agriculturae et Silviculturae Mendelianae Brunensis* 68, no. 6 (2020): 973–86.

[36] Constitutional Court of the Czech Republic, Judgment of 18 July 2023, Ref. No. 24/23.

The article has demonstrated that the majority of revenues for the Czech municipalities are derived from taxes. The shared taxes represent the most significant source of revenues, with the real estate tax representing a relatively minor contributor. For further research in this respect, the topic of tax revenue distribution is currently under discussion in the Czech Republic. From the author's perspective, the issue with the Czech legislation is that the Czech municipalities receive a significantly lower amount of revenues from taxes and levies on manufacturing plants on their territory than municipalities in other countries. Local municipalities have the option of imposing a tax on manufacturing plants through the aforementioned local coefficient, which serves as an instrument of property tax. However, even when utilized to its fullest extent of five, this incentive is not particularly motivating for municipalities to support these plants within their territory. In this regard, a distinctive study was conducted in the Czech Republic, which compared the structure of taxation of manufacturing plants in the Czech Republic, Germany and Austria as well as the calculations of the tax benefits of plants to the public budgets of these countries. The analysis indicates that the Czech municipalities perceive the location of factories in their cadaster to be more advantageous than previously, yet the system of tax budgeting in other countries provides municipal budgets with significantly greater revenues.

According to the author, if there is no change in this respect, municipalities will continue to refuse rather than welcome business investments on their territory, because the current system provides them with a certainty of their revenue, which, moreover, grows every year, regardless of the activity of the municipalities themselves.

5. Conclusion

The majority of inhabitants invest a portion of their income into assets. Consequently, the majority of countries impose some form of property tax. Such taxes may be imposed on either a portion of the wealth (stock variable) or on the net value of the wealth or the addition to the wealth (flow variable).[37] In the Czech Republic, the sole property tax is the real estate tax.

[37] Jan Široký and Michal Krajňák, *Základy daňové teorie: cvičebnice* (Praha: Wolters Kluwer, 2015), 73.

With regard to the examined tax yield, the author found that over the last ten years, the real estate tax collection has increased by an average of 2.5% per year. The greatest increase in tax revenues occurred between 2019 and 2020, specifically a 7.42% increase in tax collections. Furthermore, Figure 4 demonstrates that total revenues and tax revenues grew at a faster rate than real estate tax collections during the analyzed period. Furthermore, the growth in total municipal revenues between 2013 and 2023 was quantified, with an increase of 92.47% observed in 2023 compared to 2013. With regard to tax revenues, it was found that municipal tax revenues increased by 110.65% in 2023 in comparison to 2013. Finally, the real estate tax revenues were determined, which increased by 28.05% in 2023 compared to 2013.

It has been demonstrated that real estate tax does not constitute a significant proportion of the revenues of municipal budgets. Nevertheless, the consolidation package and the changes it has brought to this tax should result in an improvement in this situation and a greater approximation to the average yield of this tax as quantified by the OECD or the EU. The author considers the absence of corrective elements in relation to vulnerable households, for example in the form of exemptions based on wealth, to be a negative aspect of the current legislation. The author believes that this correction should be implemented in conjunction with the tax increase, which was significantly influenced by the amendments to the legislation introduced by the consolidation package.

It is important to note that property tax is a typical local tax in many countries and is a crucial source of revenues for municipalities in the preparation of their municipal budgets. The author, in line with Boháč, considers the budgetary determination of the tax to be one of the fundamental structural elements of the tax.[38] In this regard, the original proposal of the aforementioned consolidation package, which proposed that a portion of the proceeds of this tax be redirected from municipalities to the state budget, was an unwarranted intrusion. Nevertheless, this particular proposal was ultimately abandoned, with the full amount of the tax remaining with the municipalities.

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38 Radim Boháč, *Daňové příjmy veřejných rozpočtů v České republice* (Praha: Wolter Kluwer ČR, 2013), 77.

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Characteristics, Legal Nature and Taxation of Management Contracts According to the Macedonian Law

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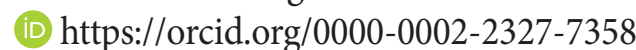
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Keywords: managerial contract, rights and obligations, employment legal status, taxation, contributions, legal consequences of the termination of the contract

Abstract: Managerial contracts are essentially synthesis of the power of management and the power of the leadership of the company. The conclusion of management contracts is not a simple and routine task which the contracting parties will easily access or, on the other hand, they will assign that task to other (third) persons. With the adoption of corporate decisions by the company, at the moment of appointment to the management body, and thus becoming a member of the body, rights and obligations determined by law arise. In the process of transferring the status powers to the management body or the manager, the owners of the companies or their representatives inevitably have to share a part of the power with the elected managers. The managerial contract is an act of free entrepreneurial will of the two parties that conclude the contract. Thus, this contract regulates the salary, allowances, participation in profit, reimbursement for expenses, reimbursement for life insurance, insurable income, and other employment rights and obligations. On the other hand, managers as individuals facing professional risk are to create a professionally based coalition of interests of all those involved in realizing the company's corporate goals and business policy and thereby enable economic growth and development.

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1. Introduction

The problem related to management contracts[1] has become particularly significant and relevant in the last few years. Its actuality comes to the fore especially after the adoption of the new Company Law Act in 2004, which sets the normative foundations for the existence of management contracts in the Republic of Macedonia. Two decades later, the impression is that the research and professional practice related to the issue in question in our country is at a relatively low level.

It is more than clear that the dilemmas in practice were and still are tremendous, starting from the legal nature of management contracts, the content aspect, the determination of the status position of managers, their employment-legal status, taxation of income, insurable incomes, terminological ambiguities and inconsistencies in the laws, the "interference" of laws in the determination of the status position of the managers, the insufficient demarcation of the different echelons of management in the company, etc.

The determination of the type and volume of total income and other rights and obligations arising from the employment relationship of the manager is appropriate to the type and volume of tasks entrusted to and the responsibility of the manager, as well as the manager's personal contribution to the success of the company's operations. Accordingly, the application of compulsory and voluntary social contributions and the taxation of personal income differs in some respects from the "normal" employment contract.

For the purposes of this paper, an analysis has been conducted of the legal framework and domestic laws that set the rules and provisions for management contracts. Additionally, a comparative approach will be used to explore the contractual provisions in the manager contract *vs* the regular employment contract. The historical method will facilitate the chronological analysis of the laws and provisions no longer in force or repealed, with laws in force and enforceable provisions.

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[1] In this paper, both terms "manager contract" and "managerial contract" are used without referring to the specifics of these terms used worldwide.

Hence, one of the main goals of this paper is to answer the aforementioned dilemmas and ambiguities, emphasizing the previous judicial practice related to the issue in question and the challenges of adopting the new Law on Personal Income Tax.

2. The Individual Existence of the Contract for Regulating the Relations of Business Persons with the Company

The contract regulating the relations of business persons with the company, has certain specificities. That contract must have a certain form and include specific answers to all the questions asked about the status, business and legal powers, compensation and the evaluation of the results of the operation, the resolution of disputed issues and the determination of the responsibility of the business persons in the company. For those reasons, such a contract should be seen as a type of business statute, which delegates specific rights, obligations and responsibilities to business persons, interrelated with the established business venture or the management of the company.[2]

When defining the concept of a management contract, it is necessary to consider the legal definitions established in the Company Law. These legal definitions refer to two different legal institutions, namely:

- "agreement for the regulation of relations between the company and an executive member of the board of directors, a member of the management board, that is, a manager" which is an agreement that regulates the mutual rights and obligations between the company and an executive member of the board of directors, a member of the management board, that is, the manager; and
- "agreement for regulating relations with a manager" which is an agreement that regulates the mutual rights and obligations between the company, represented by the management body and the manager.

These agreements represent the joint relationship of those facing entrepreneurial risk (investors, owners) and managers as those facing professional risk. Managerial contracts are essentially a synthesis of the power of management and the power of leadership, a type of document that establishes a partnership between those who have a business vision and willingness to invest funds and managers who, as co-owners, accept

[2] Zoran Mihajloski, *Pravniot status na delovnite lica* (Skopje: Selektor, 2010), 31.

the professional challenge of that business vision to bring it to life. Success and the realization of corporate goals as a motivational set largely coincide for both parties and are an incentive in the process of negotiation and the conclusion of the management contract.

Agreement (contract) for regulating the relations between the company and an executive member of the board of directors, or a member of the management board, i.e. a manager, which is an agreement that regulates the mutual rights and obligations between the company and an executive member of the board of directors, or a member of the management board, i.e. the manager and the contract for regulating relations with a managing person, which is an agreement that regulates the mutual rights and obligations between the company, represented by the management body and the managing person, are *sui generis* contracts determined by the Macedonian Company Law. In principle, these agreements are partnership agreements between those who own the business idea and those who believe that they are capable of turning that idea into a business result.[3]

The management contract by definition is an act of free entrepreneurial will of the two parties agrees to conclude the contract, a document that realizes the professional synthesis of the power of money, the power of knowledge and the power of partnership. The key role of managers as those facing professional risk is to create a professionally based coalition of interests of all those involved in the realization of the company's corporate goals and business policy and thereby enable economic growth and development.

An agreement to regulate the relations between the company and an executive member of the board of directors, a member of the management board, belongs to the category of agreements of autonomous law. However, when defining this contract, there are still certain dilemmas whether it is a regulated, named contract within positive law or it is unnamed, i.e. an unregulated contract, which, more or less, depends on the will of the contracting parties. Therefore, the management contract is presented as a purely binding contract between equal contracting parties (the company and the manager). The subject matter of the contract is the application of

[3] Tito Belicanec, *Komentar i vodic niz Zakonot za rabotnite odnosi* (Skopje: Zdruzenie na pravnici od stopanstvoto na Republika Makedonija, 2006).

managerial intellectual know-how in running an enterprise, with elements of an "normal" employment contract.

3. Regulation of Relations between the Company and Business Persons

With an agreement to regulate the relations between the company and an executive member of the board of directors, a member of the management board, i.e. manager, the will is expressed between the parties for the realization of management decisions on related principles or rules that direct decision-making in business functions and preparation of the plan of the individual business functions.[4] The relations between the company and the members of the management body are, as a rule, arranged on a status basis. Based on law, a person is appointed to the position of a member of the management body, and the authorized body issues an act on behalf of the company by which that position is awarded. The act by which one is appointed to the position of a member of a management body is by its nature a corporate act. The members of the board of directors, that is, the members of the supervisory board, are appointed to their position based on the decision of the assembly, while the members of the management board are appointed to their position based on the decision of the company's supervisory board. All these decisions are simple because they are based on the powers contained in the law. At the moment of the election, that is, the appointment to the management body, a set of rights and obligations determined by law arise.

The rights and obligations acquired by the member of the supervisory or management board, the member of the board of directors, as well as the executive member of the board of directors, are determined and defined by the Company Law. The decision to elect the board of directors or supervisory board, and its members, enters into force from the day of adoption. However, some of the rights and obligations determined by law, as an exception, may be regulated differently, if so provided by law. Such is the case when individual members of the management board of the company are deprived of their right to represent the company, a right which is

4 Bobek Suklev, *Uspesen modern menager, Lawyer* (Skopje: Macedonian Lawyers Association Journal, 2000).

vested in them by the law, but with a decision of the management board, in accordance with the supervisory board, the right of representation can be granted to some members of the management board. Also, by an act which is in its nature a corporate act, the board of directors appoints the executive members – managers of the board of directors.

The relations between the company and business persons can be regulated on a contractual basis. The Company Law does not exclude the possibility that these relationships, despite being established on a status basis, may also be established on a contractual basis. Relations based on a contractual basis are not established with all members of the management body of the company, only some of the members of these bodies have the privilege to establish contractual relations to regulate the issues related to the position of a member of a company' body. When regulating the rights and obligations of the members of a company's bodies, the Company Law stipulates that only executive members of the board of directors and the members of the company's management board can conclude an agreement to regulate the relations between the company and a member of the company's body.[5]

The possibility of the company concluding such an agreement with non-executive members of the board of directors and the members of the supervisory board of the company is excluded. Determining the status of managers in the company is not only a matter of a logical introductory form of the management contract. In the matter of determining the status of the managers, the act based on which the decisions for the selection and appointment of the managers are made, i.e. concerning the members of the management body, and the authorization of the person representing the company, the status position should be clearly stated. With regard to the manager in the company, the contractual powers and limitations in the legal transaction and representation of the company, as well as the general and special acts that determine the rights, obligations and responsibilities of the managers that are not covered by the management contract should also be defined.

[5] Milan Nedkov, *Upravuvanje so akcionerski drustva, Sovet na korporativno upravuvanje* (2005), 98.

4. Legal Nature of the Management Contract

The status, that is, the position of an executive member of the board of directors, or the member of the management board, is acquired only on a status basis, by a corporate act passed by an authorized body of the company. The financial and material position of the executive member of the board of directors or the member of the management board, is significant for relations that are established on a contractual basis. However, management contracts are not only a legal instrument or a formality with which wages, benefits, rights and obligations are regulated between the contracting parties in relation to the operation of the company and other particulars of mutual relations, but it is a key document in which success depends significantly on the specific job. For those reasons, the Company Law expressly prohibits executive members of the board of directors or members of the management board from entering into an employment contract. With the agreement that regulates the relations between the company and the executive member of the board of directors, or a member of the management board, i.e. the manager, salary, monthly allowance, the right to life insurance and other types of insurance, the right to compensation for travel and other expenses, the right to participate in the annual profit (payment in money, shares, dividends etc.) and other rights can be arranged and determined. With the conclusion of the management agreement, certain obligations established by law arise in the exercise of the authority of the executive member of the board of directors, member of the management board, i.e. of the manager in the interest of the company (managerial obligations), attention to orderly and conscientious trade, keeping of business secrecy during and after the termination of the mandate, prohibition of competition and obligation to disclose conflicts of interests and transactions with interested parties.

While investors and company owners can make decisions based on personal judgments in investing in a business venture, often guided by bare intuition, since they are putting their own funds into the project, and thus taking on their own risk, it is expected of managers that they will assess the sustainability of a given business plan professionally and responsibly, and, based on that assessment, accept or not accept personal involvement in its implementation. That is, in contrast to other

knowledge, skills and abilities that can be relatively easily obtained from the labor market with adequate remuneration, managers have a specific value because they cannot be easily replaced. They do not offer their time at rates according to the company's collective agreements, but what they offer is their entire career, work energy and their ability to concentrate on the prospects of the business venture, while taking personal, professional and legal risks.

Managerial contracts by their legal nature are contracts of autonomous law. It is a special *sui generis* legal institution predicted in the Company Law. In terms of their form and content, management contracts reflect the imperative mandate, i.e. of the business-legal relations of the company and its management, rather than of clearly qualified and measurable proposals for cooperation, on which the established corporate goals, mutual rights, powers and responsibilities are based, including and the remuneration of managers. When preparing and concluding the contract for the regulation of relations between a member of the management body and the company, it is necessary to refer exactly to the legal norm that governs these contracts, in order to know what level of management it refers to. This is of particular importance if it is known that to exercise their powers established by the Company Law, executive members, i.e. the members of the management board, can appoint managers who manage the day-to-day governance of the company in accordance with the decisions, guidelines and instructions of the executive members of the board of directors.

An executive member of the board of directors, or a member of the management board, that is, a manager for the time for which they were elected, can perform the function with or without an employment relationship. When they perform the function based on an employment relationship, they exercise the rights resulting from such a relationship according to the conditions established in the agreement regulating the relations between an executive member of the board of directors, or a member of the management board, i.e. manager and the company, in accordance with the Company Law on Commercial Companies. The provisions of the Law that refer to the executive member of the board of directors and the member of the management board also apply to the manager of other forms[6] of

[6] I.e. Limited Liability Company.

commercial companies. The contract for the company determines the manner and conditions under which they are applied unless the function is not performed under an employment relationship. On the other hand, according to the Company Law, the provisions of collective agreements, as well as the provisions of the Law on Labour Relations refer to the establishment and termination of employment, disciplinary liability, salary, benefits and protection of workers' rights. These persons (managers) exercise their rights in the manner established in the contract and according to contractual conditions.

5. Characteristics of the Management Contract

A basic characteristic of management contracts is their autonomy expressed by certain specificities that give them the character of *sui generis* contracts. These contracts are not substitutes for the employment contract that establishes an employment relationship.[7] The management contract specifies the role of the manager and mutual rights, powers, obligations and responsibilities on a contractual basis. Although at first glance the form of the entrusted mandate seems to be a less significant question, the management contract itself represents a mandatory legal framework of the will of the company and the manager. The managerial contract set up in this way requires that, even in the negotiation phase, the attitudes regarding the work-legal and material conditions must be harmonized with the assumption of the mandate.

The form and legal framework of the individual hiring of managers vary from case to case, but every well-established management contract must provide for several basic parameters in its content, namely: the manager's obligations, powers and responsibilities, the manager's work-legal status, the way of communication and monitoring the execution of business policy goals, motivation and reward for achieved results, business ethical rules, insurance against business risks and the issue of compensation from the damage caused, compensation for the manager and the way of interpreting the changes and the termination of the management contract. Given that most answers to the above questions are covered and determined by legislation, experience shows that it is much better, and in any

[7] Zoran Mihajloski, *Menadzerski dogovor* (Skopje: Selektor, 2014), 150.

case, it is advisable, to incorporate all the specifics and the agreed positions for cooperation into the content of each specific management contract.

The individual character of the management contract dictates that the presented recommendation finds its application, all the more so that in North Macedonia, unlike in European Union countries, as a rule, no standards of corporate management or ethical codes have been developed, so there is room for arbitrary interpretation of external regulations and the very content of internal agreements.

Considering the overall situation and experiences regarding the conclusion of management contracts in the Republic of Macedonia, the way of setting the elements in the contract is of particular importance. Namely, it is necessary to make the essential provisions of the management contract as detailed and understandable as possible, while using unambiguous concepts and categories. At the same time, the specificities of certain rights, obligations and responsibilities that cannot be expressed in numbers or formulas should be covered descriptively and raised to the level of definitions, using keywords. The Company Law does not provide a solution in what form the contract should be concluded, however, starting from the essence and character of such a contract, it must be concluded in writing. For the methodological way of drafting a management contract, the experiences from the Anglo-Saxon practice are of particular benefit. In Anglo-Saxon law managerial contracts are identical in form to letters of intent, that is, they are fairly specific as a result of the substantial meaning of the manager's mandate. In their content, they avoid redundant provisions in terms of professional obligations and powers. This is because they are essentially understood, as either they are covered in legal regulations or elaborated in detail by the corporate acts of the company. That is why issues are precisely defined in terms of corporate goals, powers, obligations, deadlines, basic salary, conditions for the realization of awards, various compensations related to the work, anti-competitive clauses and more. Compared to the Macedonian law, the content of the structure of most management contracts in the bulk of the text contains paraphrased quotations of legal provisions or stylization of general rights, powers and responsibilities of the parties to the contract.

6. Parties to the Management Contract

When determining the status of managers in the company, the introduction to the management contract should clearly state the act based on which the decisions for the selection and appointment of the managers are made, i.e. the members of the management body, and the authorization of the person representing the company, the status position of the manager in the company, the contractual powers and limitations in the legal turnover and representation of the company, as well as the general and special acts that determine the rights, obligations and responsibilities of the managers that are not covered by the management contract.

The rights and obligations of the executive members of the board of directors/the members of the management board, i.e. the manager, in addition to the rights and obligations determined by law, can also be determined by an agreement (contract) to regulate the relations between the company and an executive member of the board of directors, or member of the management board, that is, the manager. The Macedonian Company Law determines the parties that conclude the management contract. On behalf of the company, the contract with an executive member of the board of directors is concluded by the non-executive members of the board of directors and signed by the president of the board of directors. In the two-tier system of managing the company, the contract with the members of the management board or the manager is concluded by the supervisory board and signed on behalf of the company by the president of the supervisory board. The board of directors, in accordance with its powers, applies for registration of the executive members authorized to represent the company in the commercial register. The representative of the company is a natural person who, according to the law, is authorized to represent the company. The application is signed by all members of the board of directors unless the members have given written authorization to an executive member of the board of directors to sign it. When registering with the commercial register, the executive members submit signatures certified in accordance with the provisions of the Law. The Law provides continuity in the process of creating management contracts, with their negotiation at the initial stage, followed by the conclusion and signing, and finally application for their registration with the commercial register. The Company Law stipulates that a company management body can

decide to appoint persons with special powers and responsibilities called managers. Managers exercise their rights and obligations in the company according to the conditions established in the agreement regulating the relations between the management body and the managing person.

The contract for managing the relations with managers, which by its nature has all the elements of a management contract, regulates the salary, allowances, participation in profit, reimbursement of expenses, reimbursement for life insurance and other types of insurance, as well as other employment rights. In the content of the contract, the type and amount of total income and other rights of the manager should be determined in great detail, to correspond to the type and volume of entrusted tasks and the responsibility of the manager, as well as the manager's personal contribution to the success of the operation of the company. The success and realization of business policy goals as a motivational set in a company must largely be in accordance with the mutual connection and professional relationship of the two contracting parties and be encouraged in the process of negotiation and conclusion of the management contract. The contracting parties of the management contract create a professionally based coalition of interests of all those involved in the realization of the business policy goals of the company and thereby enable economic growth and development. On behalf of the management body of the company, the contract with the managing person is signed by the president of the management body. The regulation of relations between companies and business persons is largely harmonized with the regulation of this issue applicable in the European Union, and it includes the principles of corporate governance accepted in wider international frameworks.

The problems related to the legal framework regulating relations between the management and the company are covered by different legislations mainly in laws concerning company law. For example, in Serbian legislation, management contracts are governed by the Company Law, the Law on Labour, the Law on Contributions and Mandatory Social Insurance, the Law on Pension and Disability Insurance and other related laws. Similarly, to Serbian legislation, Croatian legislation regulates this issue in the Law on Commercial Companies and other regulations governing the framework of powers and responsibilities of managers in legal action.

Polish legislation regulates the relationship between management and the company in a much more detailed manner in two main regulations: The Code of Commercial Companies and the Labour Code. Also, with regard to this matter, and especially to the remuneration of managers, the Civil Code of Poland has a significant place. It should be considered that the rest of the European countries regulate these relations in a similar way, based on the relevant European directives, which will be discussed separately in the paper.

In the USA, the judicial reasoning concerning management contracts has focused on the question of the decision-making autonomy of the companies themselves. Whether a management contract is considered valid depends on the degree of delegation of the management function.[8] The board of directors can give authority to act, but it cannot delegate its function of management. Thus, the management is not legally authorized to replace the board of directors of a company. In that context, the courts consider criteria such as the duration of the contract and who has the authority to make the final decision regarding the company's business policy.[9] The principle of non-delegation[10] applies even if the company's shareholders have approved the management contract.[11]

Legal regulations for management contracts are found in the Investment Company Act of 1940. This law covers contracts between investment companies and investment advisers. The permissibility of these agreements is presumed. The law provides that they should prevent the adviser from exercising too much influence and ensure the reasonableness of their remuneration. The agreement is subject to specific conditions regarding the approval of outside directors. In the case of long-term contracts, re-consent is required. The Public Utility Holding Company Act of 1935 places the management contracts of public utilities and companies that provide public goods and services under the supervision of the Securities and Exchange

8 Kennerson v. Burbank Amusement Co, 120 Cal. App. 2d 157, 260 P.2d. 823, 832–833 (1953); Manson v. Curtis 171 A.D. 954 (1915), aff. 223 N.Y. 313 (1918); McQuade v. Stoneham 263 N.Y. 323, 189 N.E. 234 (1934); Clark v. Dodge 269 N.Y. 410, 199 N.E. 641 (1936); Long Park Inc. v. Trenton-New Brunswick Theatres Co et al 297 N.Y. 174 77 N.E 2d 633 (1948), p. 28.

9 Sherman & Ellis Inc. v. Indiana Mutual Casualty Co 41 F 2d 588 (7 Cir. 1930).

10 Cf. Henn 425.

11 Grossfeld supra ch 4 p. 111, kritika Lattin, Jennings and Buxbaum 309.

Commission. The fundamental issue in these contracts is the reasonableness of the relationship between performance and consideration. The two features that are given particular attention are the limitation of compensation to actual costs and the allocation of costs between individual subsidiaries. In France and England, management contracts are also allowed but only to a limited extent. Since they are rarely mentioned in the relevant literature, such contracts do not seem to have any practical significance.

7. Benchmark for Rewarding Managers and Taxing Them

The determination of the type and amount of total income and other rights and obligations from the employment relationship of the manager is adequate to the type and volume of entrusted tasks and the responsibility of the manager, as well as their personal contribution to the success of the company's operations.

The Company Law stipulates that the executive members of the board of directors and the members of the management board of the company have the right to a salary, that is, a monthly allowance, the right to life insurance and other types of insurance, reimbursement of travel and other expenses and other rights. Additionally, the executive members of the board of directors or the management board have the right to participate in the company's profit. Consequently, the most important components for assessing the manager's salary in a specific company are the status of that company in the market in which it operates, the content of the established business policy goals, the complexity of the manager's role in the specific company, the professional reputation of the candidate for manager, the structure of the total ambiguities and vagueness and the attractiveness of the assigned mandate and salaries compared to those offered by the competition.

The data and arguments about the status of the company indicate that company's recent and present position in the market in which it operates. These factors can be divided into several groups, namely:

- size of the company depending on the number of employees and volume of work;
- state of the ownership structure in the company expressed through the indicators of the capital structure;
- the financial power of the company expressed through the available own sources of financing, income, costs and profitability;

- the organizational complexity of the company's business venture, which can be either a small, medium or large organizational unit;
- the complexity of the production program expressed in the number and types of products, their quality and technical equipment, and
- the position of the company in the market and its competitive position.

The second component for determining the manager's salary represents a set of parameters by which the justification of the company's business policy goals can be expressed. As a set of desired changes, they can be expressed descriptively or with concrete projects in temporal and financial dimensions. Their viability depends on the behavior of the company and its competitive position, the complexity of the market, the quality of the available resources and the content of the production program. The complexity of the manager's role in the company is a significant component in determining the basic salary of managers provided for in the management contract. The attractiveness of the basic salary will also depend on the professional references of the candidate, as well as on the framework and intensity of the responsibilities of the assigned mandate. These factors will equally affect other components for evaluating and determining the salary of managers. However, certain essential rules systematized in several categories are of great importance for determining the salary in the negotiation between the contracting parties before the conclusion of a management contract. These rules say that:

- if the amount of the manager's salary stipulated in the management contract and other permanent compensations is higher, it entails a proportionate reduction of the share of remuneration on account of participation in the profit and shares of the company;
- the manager's salary is not a gift and it should be earned to the extent that the company's business policy goals are met, i.e. by delegating the powers and trust to manage the company's operations, managers invest a lot in the development of their own career and as such have numerous alternatives in the labor market (demand and supply of managers);
- the salary must be sufficiently motivating for the managers to be part of the company's mid-term and long-term development business goals;
- the salary should be a measure of the professional reputation and prestige of managers, which tends to make their salaries proportionate to

the position and reputation of the owners of the company in the market;
- the salary should be projected in such a way that it compensates in advance the possible inflation and the rise of living costs during the mandate;
- if the owner of the company offers a relatively low salary to the manager and high expectations for rewards and other benefits, it implies that they are interested in a manager-entrepreneur willing to take business risks, or they believe that the company's business policy goals are easily achievable;
- if the owner of the company offers the manager a relatively high salary and a modest package of benefits, it means that they are interested in a manager-professional not willing to engage in high-risk games who considers that the company's business policy goals are not easily achievable, and
- if the manager accepts a relatively high salary, it leaves them more room in the negotiations for the conclusion of a management contract to better position themselves with regard to the rewards and other benefits arising from the assigned mandate, and above all in the fair participation in the business profits, through different forms of rewards.

The rights of the executive members of the board of directors, and the members of the management board, i.e. the manager, are regulated by a management agreement, according to the type and scope of the entrusted tasks, the work-legal status and their personal contribution to the success of the company's operations. In addition to the right to salary, i.e. monthly compensation, for the work of the executive members of the board of directors, and the members of the management board, i.e. the manager, the assembly can also decide to approve profit sharing.

The approved participation in the annual profit of the company is calculated based on the part of the annual profit that remains after the reduction of the realized profit by the amount of the total losses carried over from previous years and the amounts set aside for reserves.

As mentioned above, the status of the managers is mostly based on dispositive legal rules, which gives the executive member of the board of directors, and the member of the management board, or a manager the right to agree to this position with or without employment status. As mentioned

above and prescribed in Article 365 paragraph 2 of the Company Act, "The executive members of the board of directors, the members of the management board, or the manager, shall be entitled to a salary, or a monthly remuneration, right to life insurance and other types of insurance, compensation of travel and other expenses and other rights" and in Article 366 paragraph 2 of the aforementioned Act:

> Unless an executive member of the board of directors, a member of the management board, or a manager performs their functions without establishing an employee status, they shall, within the time period they were elected for, exercise the rights arising from such employment status according to the terms stipulated by the agreement regulating the relations between executive members of the board of directors, members of the management board, or manager, and the company.

In both cases, the parties are free to agree upon the duties and rights under the provisions of the Company Law.

If the manager does not have an employment-legal status in the company under a management contract, the tax basis will be the total remuneration, the personal income tax is 10% and usually charged to the company. Income tax is payable by a person on their income earned from various sources during the fiscal year based on their residential status. Macedonian tax residents are taxed on their worldwide income. Non-residents are taxed on their income derived in the territory of Macedonia. "All types of revenues earned in the country and abroad are included in the income"[12] and personal income tax needs to be paid. Personal income tax is paid annually on the sum of the net revenue from all sources, except for the revenues that are tax-exempt under the Law on Personal Income Tax. Those are revenues mentioned in Article 3 of the same Law: personal income from employment, income from self-employment, income from royalties and other related rights, income from sale of own agricultural products, income from intellectual property (IP) rights, income from lease and sublease of movable and immovable property, income from capital, capital

[12] Article 3, Law on Personal Income Tax.

gains,[13] income from fixed-term deposits,[14] income from insurance, and other incomes.

If the manager has an employment-legal status in the company according to the management contract, in addition to the salary determined by the contract, the social contributions are paid for the manager, and tax reductions are applied as well, thus, the tax basis for personal income tax is lower. The company is liable for the calculation and payment of the contributions on behalf of the manager. The company (Employer) is required to calculate and withhold compulsory social security contributions and personal income tax from the manager's (employee's) gross salary and pay them into the accounts of respective funds. These are public funds (pension, health). The current level of compulsory social security contributions is as follows:

- 18.8% for mandatory pension and disability insurance (that is composed of the pay-as-you-go system and the mandatory capital fully founded[15]);
- 7.3% for mandatory health insurance;[16]
- 0.5% rate of additional contribution for mandatory health insurance in case of injury at work and occupational disease, and
- 1.2% for mandatory unemployment insurance contribution.

Personal income tax is calculated according to the Law on Personal Income Tax, using the tax and benefit microsimulation (MK-MOD) model. This model uses the Law on Pension and Disability Insurance to simulate pensions in cases of the right to old-age pension and the right of the lowest pension amount.

Personal income tax is calculated as a flat rate of 10%. The new Law on Personal Income Tax[17] adopted in 2018 with effect as of January 1, 2019

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13 As of January 1, 2023, the applicable tax rate on capital gains from sale of securities and shares issued by an investment fund will be 0% if the taxpayer has owned them for a period longer than two years.

14 The taxation of income from fixed-term deposits is postponed until accession of North Macedonia to the European Union.

15 The pension system in the Republic of North Macedonia is regulated by the Law on Pension and Disability Insurance and the Law on Mandatory Capital Fully Funded Pension Insurance.

16 Law on Compulsory Health Insurance.

17 Law on Personal Income Tax, Official gazette of Republic of North Macedonia No. 241/2018; 84/2019; 275/2019; 290/2020; 85/2021; 274/2022.

introduces progressive taxation.[18] Article 11 of the Law on Personal Income Tax stipulates that for any labor income earned, a progressive rate of 10% should be paid for the earned income up to 1,080,000 MKD per year, and 18% for any income earned above this threshold. The endorsement of this provision was postponed every year starting in the COVID-19 period, and, as of January 1, 2023, a 10% flat tax rate is applicable on income from employment. Progressive taxation has not become applicable so far.

In Macedonia, management contracts include confidentiality clauses, thus it is difficult to say what amounts of salaries, remuneration and profits are involved, but it can only be concluded that there are no limits when it comes to managerial salaries, remuneration awards or bonuses. The availability of this data differs in different legal systems and generally depends on the model of corporate governance. By comparison, in Europe, the disclosure of this data primarily for publicly owned joint stock companies is as follows: Great Britain and the Republic of Ireland have the most advanced systems for disclosure of data regarding the remuneration of directors and management. Data are published for each director separately on an annual basis. It is similar in France.[19] Unlike these countries, Germany delayed the implementation of European data disclosure directives for a fairly long time because the right to anonymity in the amounts earned was considered a "natural right" according to the existing model of corporate governance.[20]

8. Conclusion

Managers can successfully perform their duties and functionally and professionally perform their role as executive members of the board of directors only if the management body in the company has determined the general framework of business activities in the company. The manager's functions have to be performed professionally and responsibly and they involve the obligation to assess the viability of any business venture.

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18 Progressive taxation on individuals was in force until 2006 when flat taxation was introduced with a 12% rate until 2008, and later 10%. Currently, the rate of 10 % is still applicable.

19 Goran Koevski, *Komparativno korporativno upravuvanje*, Faculty of Law, Skopje, 2005, 223–4.

20 John C. Coffee, "The Future as History: The Prospects for Global Convergence in Corporate Governance and its Implications," Columbia Law School Center for Law and Economic Studies Working Paper No. 144, 1999, 62.

Managerial contracts are essentially a synthesis of the power of management and the power of the leadership. The basic characteristic of these contracts is their autonomy expressed by certain specificities that give them the character of sui generis contracts. It is important to emphasize that during the preparation and conclusion of the management contract, it is necessary to refer precisely to the legal norm that governs these contracts, in order to know what level of manager it refers to.

It is extremely important to note that the provisions of the Law on Labour Relations and collective agreements that refer to the establishment and termination of employment relationships, disciplinary responsibility, salary, benefits and protection of rights under an employment relationship do not apply to the executive members of the board of directors, or the members of the management board or the manager and the officers. These persons exercise all the mentioned rights in the manner and according to the conditions determined by the management contract under the Macedonian Company Law. It cannot be said that the Republic of North Macedonia has some significant experiences regarding the existence of such contracts in legal reality. However, it seems that the previous judicial (and legal) practice showed certain shortcomings in the creation and application of management contracts in domestic frameworks. In this sense, it is of significance that the judicial practice has arguably taken consistent and legally sound positions concerning strategically important issues and the conceptual setting of management contracts. However, it seems that even more work will have to be done in terms of the training and specialization of all stakeholders, including the courts. In particular, further training and specialization in commercial law should be provided to judges who, from a logical perspective, should decide on cases related to management contracts.

The Macedonian Company Law stipulates that the executive members of the board of directors and the members of the management board of the company have the right to a salary, remuneration as members of the management bodies and reimbursement of costs from employment and all other allowances related to work provided for under the Labour Law, General Collective Agreement for the private sector, collective bargaining agreements and regulations for the state administration bodies, which is

to be determined by the company. Based on their intrinsic characteristics, it may be said that these contracts are *sui generis* contracts.

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Combating Food Waste: Legal Analysis and Fiscal Solutions in the Italian and European Context

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Keywords:
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Abstract: This contribution aims to analyze the new measure of Food Income, an Italian legislation that has been introduced recently to combat food poverty. This tool enables the free distribution of food parcels made from unsold commercial products, donated by participating businesses to people in absolute poverty. Beginning with the analysis of the measure, which is currently being tested in some Italian municipalities, the goal of this contribution is to provide a comprehensive overview of current practices and developments in addressing food waste within the Italian legal system, offering a comparative and multilevel perspective on the multiple purposes that can be served by a sustainable food chain.

1. Introduction

In recent years, Italy has faced a series of food-related issues, particularly food waste, which has prompted the need for new fiscal, political, and social solutions. The evolving perception of citizens not merely as taxpayers

The themes of this contribution have been developed in the context of the research work carried out for the Horizon Europe Seeds project "Sistemi agroalimentari, nutrigenomica e alimentazione: regole dell'agricoltura e dell'informazione ai consumatori" and for the project "ONFOODS – Rete di ricerca e innovazione sulla sostenibilità, la sicurezza e la protezione degli alimenti e della nutrizione – Lavorando sul Cibo".

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but as integral parts of the environment, requiring protection for collective well-being, has heightened attention to previously underexplored topics. To this end, food taxation has become a significant subject of study and analysis for tax law scholars over the past few years. Significantly, progress in environmental taxation and the circular economy has increasingly tackled food-related issues at both supranational and national levels. Simultaneously, the need for effective solutions in the food sector has gained paramount importance, particularly considering major economic changes affecting the less affluent social strata.

The convergence of theoretical and practical needs has recently led to the introduction of a new instrument in Italian legislation: the Food Bonus 2024, also known as Food Income. The term "Food Income" is therefore understood as a measure of economic support, introduced by the Italian legislator with the 2023 Budget Law, to combat food waste and help people in absolute poverty. The goal is to prevent around 230,000 tons of unsold food from large distributors from being discarded and to assist at least 3 million Italians.

This article aims to analyze the so-called Food Income measure, beginning with a normative analysis to reconstruct the Italian tax legislation on food waste, while also considering the role of local authorities in combating waste through tax leverage. By benchmarking similar instruments and measures already in place at the European level, the authors aim to extrapolate potential solutions within a regulatory system that can respond to growing national and European needs.

2. The Decree of the Ministry of Labour and Social Policy No. 78 of 26 May 2023: Normative Analysis

The Decree of the Ministry of Labour and Social Policy no. 78/2023 introduces the measure of food income, already foreseen by the 2023 Budget Law. The implementing decree, specifying that the introduction of the measure is experimental, therefore concerns the capital cities of municipalities to be identified on proposal of the Ministry of Labour and Social Policies, considering the rates of poverty that exist in the territories, the fair distribution of food on the national territory and the resources available, states that the measure aims to contribute to the fight against severe material

deprivation and food waste. The measure involves free distribution, also using third-sector entities present on the territory, of food packages containing what remains unsold in the food distribution network and donated by the commercial establishments participating in the initiative. As already mentioned, the legislative measure is introduced experimentally.

The decree outlines the content of the measure on a subjective level, indicating that the beneficiaries of the measure may be the same as those listed by the Territorial Partner Organisations (OpT) of the distribution of the programme FEAD[1], as well as other subjects reported by the relevant territorial social services and/or "third sector entities," operating in the territory. The measure, therefore, while pursuing solidarity objectives, helping people in conditions of absolute poverty, at the same time makes it possible to manage the surpluses and unsold products from large retailers, because it also includes products close to expiry or whose packaging is damaged.

The procedure of application for the benefit is a computerized procedure, created especially for this purpose by the Ministry of Labour, also to allow the correct tracking of food products and the monitoring of the presentation phases, management, control, and reporting of projects. In particular, to submit the project proposal you must send an application for authorization to the e-mail address: supporto.redditoalimentare@lavoro.gov.it.

The additional operating criteria of the measure require that: food-income projects are presented by the municipalities capital of metropolitan cities, identified following a special non-competitive notice issued by the Directorate General for Combating Poverty and for Social Planning at the Ministry of Labour and Social Policy; the projects are implemented through forms of involvement of the third sector entities, present in the territory, favoring those participating in the FEAD program and the shops.

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[1] The Operational Programme I for the European Aid Fund for the Most Deprived (FEAD), approved by the European Commission to the Ministry of Labour and Social Policy, allocates for the period 2014–2020 around € 789 million in 2020 to implement a series of measures on the national territory in favor of people in conditions of severe material deprivation, in compliance with the objectives of the new programming of cohesion policies that provide for the fight against poverty, including through the provision of aid to people in extreme poverty. In Italy, FEAD is mainly focused on financing the purchase and distribution of food.

Food income is allocated to people in a state of absolute poverty, who receive food parcels made with the unsold distribution of food stores and it represents a measure to rationalize the use of food resources, which gives Italy a prominent role in the fight against food poverty.

3. Classification of the Benefit in the Category of Tax Measures to Combat Food Waste in the Community and National Legislation

The succession of recent emergency events such as the pandemic, the threat of an international war, and the energy crisis, have aggravated the economic situation of many families, greatly increasing the number of people in poverty, including food poverty. At the same time, the problem of food waste is becoming more widespread because legislation on food labelling does not comply with the new requirements and rules of the market and the sustainability objectives that now guide the food chain, considering that all stages of the chain, from production to distribution, have a strong impact on the environment, sometimes with harmful consequences.[2]

In this context, the necessary balance between environmental protection, recognition of the right to food, including respect for the principles of solidarity and equality[3] and regulation of the food sector, have led the European legislator to set fundamental objectives, which must be implemented by each Member State. Reports from the United Nations Food and Agriculture Organization (FAO) attest that about one-third of global food production is lost or wasted at any stage of the supply chain and almost 59 million tones of food are wasted every year across the European Union,

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2 Maria Carlotta Rizzuto, "La sostenibilità come chiave di sintesi dell'economia circolare: prospettive e criticità nella filiera agroalimentare" ["Sustainability as a Synthesis Key of the Circular Economy: Perspectives and Critical Issues in the Agri-Food Chain"], *Il diritto dell'economia*, no. 1 (2023): 125–47; Luca Russo, "Le crisi protratte e l'insicurezza alimentare. Un problema in espansione" ["The Protracted Crisis and Food Insecurity. A Global Problem in Expansion"], *Gnosis*, no. 1 (2015): 57–63.

3 Marco Allena and Fabrizio Fracchia, "Globalization, Environment and Sustainable Development in Global, European and Italian Perspectives," *Bocconi Legal Studies Research Paper*, no. 3049640 (2017), https://ssrn.com/abstract=3049640; Paola Lombardi, "Ambiente e generazioni future: la dimensione temporale della solidarietà," *federalismi.it*, no. 1 (2023): 86–103; Francesco Sanchini, "La riforma costituzionale in materia di tutela dell'ambiente tra dimensione intergenerazionale e mutamenti della costituzione economica," *Osservatoriosullefonti.it*, no. 3 (2022): 183–214.

due to inefficiencies in the supply chain and consumption management. Combating food losses and waste must be considered a priority.[4]

The EU Waste Framework Directive requires Member States to reduce food waste during production and distribution; decrease food waste at the household level; encourage food donations; and monitor and evaluate the implementation of Union measures to prevent food waste.[5] In 2016, the Council of the European Union established action lines to reduce future food waste and losses, involving Member States and the Commission in data monitoring, waste prevention, public awareness campaigns, improving the interpretation of product labels, and, finally, in increasing donations of unsold food to charities.

With the European Green Deal, the Union has renewed its commitment to fight food waste, proposing to halve waste on the retail side by 2030, in accordance with the Sustainable Development Goals set by the United Nations. In 2020, the European Commission introduced a series of policies and instruments to reduce food waste. These form part of a broader strategy to implement the circular economy paradigm and the "From producer to consumer" strategy, which aims to achieve climate neutrality by 2050 and promote a sustainable food system. Food security and food safety are the main objectives of the strategy and imply the need to ensure nutritious food in sufficient quantities and at affordable prices; respect the planet's resources; reduce the use of pesticides and fertilizers; encourage organic farming; promote more sustainable food consumption and healthy diets; reduce food waste; combat food fraud in the supply chain; and improve animal welfare.[6]

From a tax perspective, the role of tax authorities and institutions is crucial for achieving environmental goals while maintaining balance with other protection requirements, such as the right to food and market fairness.

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4 "Thinking about the Future of Food Safety. A Foresight Report," Food and Agriculture Organization of the United Nations, FAO, Rome, 2022, accessed June 30, 2022, https://www.fao.org/3/cb8667en/cb8667en.pdf.

5 Daniele Camoni, "La lotta contro lo spreco alimentare nel diritto comparato," *Rivista di Diritto Alimentare* 17, no. 3 (2023): 5–23.

6 European Parliament, Risoluzione del 20 ottobre 2021, "Dal produttore al consumatore, per un sistema alimentare equo, sano e rispettoso dell'ambiente," accessed, https://www.consilium.europa.eu/it/policies/from-farm-to-fork/.

In this regard, the introduction of the Gadda Law is significant as it remains the only legislation in Italy that specifically addresses food waste.[7] More specifically, this law aims to promote environmental objectives by offering tax benefits that encourage innovation in product and production processes, in compliance with the principle of sustainable development.[8]

The key issue is the compatibility of environmental taxes with Article 53 of the Italian Constitution. Legitimacy is found in an evolved concept of the ability to pay, which justifies environmental taxes and benefits in the light of Italian constitutional principles. Today, environmental taxation is not solely based on the "polluter pays" principle but reflects a broader concept that enhances the promotional dimension of taxation.[9]

In fact, the Gadda Law is part of the international effort to combat food waste, aligning with European policies and fulfilling goals of solidarity and environmental protection. It updates the "Good Samaritan Law" to

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7 Marco Allena, "Gli incentivi fiscali nella c.d. 'legge contro gli sprechi' e nella gestione delle derrate alimentari: nuove ipotesi di tributo ambientale," *Bollettino tributario d'informazioni*, no. 12 (2017): 909–16; Maria Pia Nastri, "La riduzione degli sprechi alimentari nella transizione verso l'economia circolare," *Diritto e pratica tributaria internazionale*, no. 4 (2019): 1015–40.

8 Emiliano Frediani, "Lo sviluppo sostenibile: da ossimoro a diritto umano," *Quaderni costituzionali*, no. 3 (2017): 626–9; Antonietta Lupo, "L'innovazione tecnologica nel sistema alimentare europeo tra principio di precauzione e sviluppo sostenibile," *Rivista di Diritto Alimentare*, no. 1 (2023): 26–37; Angelo Maestroni, *La dimensione solidaristica dello sviluppo sostenibile. Dal quadro sovranazionale alle decisioni della Corte costituzionale* (Milano: Giuffrè, 2012); Antonio Felice Uricchio, "Capacità contributiva e 'agenda' del terzo millennio: dalla tutela dell'ambiente all'economia circolare," *Diritto e processo*, no. 2 (2022): 185–211.

9 "(...) environmental taxation, formerly linked to the polluter pays principle and traced to vaguely compensatory models, adheres more correctly to the model of functional taxation, characterized by the use of promotional instruments (ecoincentives) or levy to pursue purposes that do not end in mere revenue. The appreciation of promotional schemes in the analysis of tax cases thus leads us to seek and seize, alongside the primary purpose of the levy (allocation to the financing of public expenditure in accordance with the principles of ability to pay and substantial equality) and the inevitable economic effects (transfer, removal, etc.), ancillary and other purposes, including those of an extra-fiscal nature, that enhance and enhance the function of taxation, especially when consistent with the plot of fundamental values. In a broader sense, the connection between the purposes of the levy, starting with the founding ones and between the common good and environment, restores to tax rules a political value, making them privileged instruments for the implementation of public finance." (Antonio Felice Uricchio, "I tributi ambientali e la fiscalità circolare," *Diritto e pratica tributaria* 88, no. 5 (2017): 1849).

encourage donations of ready-to-eat food and prevent it from becoming waste. Although the Gadda Law consists of a single provision and does not introduce clear fiscal regulations or simplified procedures, it equates food distribution organizations with final consumers concerning food safety and use.[10]

The law defines food surpluses and waste. According to Article 2(c), food surpluses include products that, while still meeting hygiene and safety standards, are unsold, withdrawn from sale, or nearing expiry, among other reasons. Food waste is defined as food discarded from the supply chain for commercial or aesthetic reasons, still edible, and intended for disposal if no alternative use is found.[11] Donations are allowed for food with minor defects or nearing expiry. The law establishes a trilateral relationship among food business operators, donors, and recipients of free food. Donors are public and private entities set up to serve civic purposes and solidarity, which carry out activities of general interest also through the production and exchange of goods and services of social utility and mutual and third sector entities. Under Article 3, operators in the sector hand over their surpluses to donors, who allocate food transferred to the most deprived. On the procedural level, there are not special formalities and on the fiscal side, the legislator proposes a harmonization of the category of tax benefits.

The law also provides tax benefits to donors, simplifying procedures and harmonizing tax benefits for donated goods. However, VAT on purchases is not deductible. Overall, the donation of surpluses, as demonstrated by the law's application, can be a concrete measure to effectively address multiple interests.[12]

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10 Domenico Buono and Marta Proietti, "Profili fiscali della legge contro gli sprechi di prodotti alimentari e farmaceutici," *Corriere tributario*, no. 9 (2017): 711–6; Luca Giacomelli, "Diritto al cibo e solidarietà. Policies and practices for the recovery of food surpluses," *Osservatorio costituzionale* 10, no. 1 (2018): 15.

11 Monica Delsignore, "Sulla necessità di una definizione armonizzata di rifiuto alimentare per la concreta realizzazione dell'economia circolare" ["On the Need for a Harmonised Definition of Food Waste for the Concrete Implementation of the Circular Economy"], *Il diritto dell'economia*, no. 2 (2018): 329–48.

12 Maria Colurcio, Alberto Pastore, and Chiara Scrimieri, "Sostenibilità e ristorazione: una nuova prospettiva per combattere gli sprechi alimentari" ["Sustainability and Catering: A New Perspective in the Fight against Food Waste"], *Il diritto dell'economia*, no. 1 (2023): 171–86; Marcello De Rosa and Massimo Sabbatino, "Benefici delle indicazioni geografiche

In the wake of the latest regulatory measures and, therefore, the tendency of the legislator to prefer tax expenditures, the legal framework in Italy lacks systematic planning to regulate food waste, overcome the current critical issues, and support the circular economy and sustainability objectives.[13]

4. The Role of Local Authorities in the Fight against Waste

Change is inherently linked to human experience and drives the natural evolution of social and economic structures. However, while past changes occurred gradually, recent transformations have been rapid and nonlinear, making them difficult to manage. This phenomenon, often referred to as "discontinuous change," highlights the accelerating pace of change driven by scientific discoveries and technological innovations, which do not always align with the immediate implementation of new social structures or tax models.[14] In this context of constant change, it is crucial to address persistent social problems that require new and potentially definitive solutions. As evidenced by a preliminary reading of the Decree of the Minister of Labor and Social Policies No. 78 of 2023, the Food Income initiative involves public entities and Third Sector organizations as active participants. These entities are engaged both in providing food assistance to individuals experiencing material deprivation and in collaborating with food operators committed to supplying products for distribution to the initiative's beneficiaries.

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e filiera," *Rivista di Diritto Alimentare*, no. 1 (2009): 37; Angela Marcianò, "Mercato e lavoro agricolo. Dall'Agenda Onu 2030 alle 'green strategies' europee," *Rivista di Diritto Alimentare* 16, no. 2 (2022): 41–62.

13 Rocco Palma, "Agro-ecologia e indicazioni geografiche tra magia e razionalità nel diritto dell'UE e dell'OMC: 'reinventare' le designazioni d'origine per preservare l'economia rurale, il patrimonio culturale e l'ambiente," *Rivista di diritto industriale*, no. 6 (2017): 265; Maria Carlotta Rizzuto, "Cambiamento climatico: un problema di intreccio tra globale e locale. Spunti di riflessione dalla filiera agroalimentare quale modello virtuoso di circolarità e sostenibilità" ["Climate Change: An Intertwining Problem between Global and Local. Food for Thought from the Agri-Food Chain as a Virtuous Model of Circularity and Sustainability"], *BioLaw Journal – Rivista di BioDiritto*, no. 2 (2023): 253–75.

14 Andrea Comelli, "Riflessioni sulla tassazione ambientale, all'epoca della pandemia innescata dal covid-19, nella prospettiva di un'ampia riforma tributaria," *Diritto e pratica tributaria*, no. 1 (2021): 60.

From the introduction of this measure, it is clear that local authorities are essential for the success of the Food Income, particularly through the strategic and cross-sectoral use of fiscal tools. By introducing targeted tax incentives, modernizing logistical infrastructures in participating regions, and supporting the creation of public-private partnerships, local authorities can ensure not only the effective reduction of food waste but also provide concrete support to economically vulnerable social groups.

In the current scenario, the role of local authorities extends beyond the immediate promotion of this measure, in fact, their involvement is crucial for developing its long-term potential by implementing tax policies tailored to the specific characteristics of each region.[15] Specific municipalities, including the Metropolitan Cities of Genoa, Florence, Naples, and Palermo, have been selected for a three-year pilot of the Food Income initiative and it is essential to link the issue of food poverty to the unique needs of these territories, considering the economic disparities between the North and South of Italy.

More broadly, it is evident that food waste and inequality are two sides of the same coin,[16] influencing both society and the economy. While one segment of the Italian population has access to an abundance of food, entailing waste and environmental impact,[17] lower-income groups face limited food choices, resulting in malnutrition and food insecurity.[18] Economically disadvantaged families are often forced to choose

[15] Eugenio Di Raso, "Le politiche fiscali ad impatto ambientale," *Innovazione e Diritto*, no. 1 (2024).

[16] To gain a better understanding, see: Gunta Grinberga-Zalite and Andra Zvirbule, "ESG Investing Issues in Food Industry Enterprises: Focusing on On-the-Job Training in Waste Management," *Social Sciences* 11, no. 9 (2022): 424, https://doi.org/10.3390/socsci11090424.

[17] Richard Tiffin and Matthew Salois, "Diseguaglianze nell'alimentazione e nella nutrizione," in *Obesità e tasse. Perché serve l'educazione non il fisco*, ed. Massimiliano Trovato (Milano: IBL Libri, 2013), 144.

[18] According to the Italian Food Insecurity and Poverty Observatory, promoted by Cursa – University Consortium for Socioeconomic Research and the Environment, in 2022 about 3.4 million people in Italy suffered from severe or moderate food insecurity; at the same time, about half of the adult population in Italy is overweight or obese. The Observatory in the 2023 makes it clear that food problems in Italy are not related to the scarcity of available resources but to their access. According to Eurostat data from 2022, 7.5 per cent of the Italian population cannot afford a meal containing meat, fish or a vegetarian equivalent every other day; 15.5 per cent cannot afford a proper meal. The current diet of Italians is 30%

low-quality, nutritionally poor food, leading to harmful eating habits that increase both the risk of chronic diseases and the strain on the public health system.

In this light, taxation can play a crucial role in combating waste and pollution by implementing environmental taxes and offering tax breaks that encourage virtuous behavior in production, consumption, and individual lifestyles. These incentives could be further refined, particularly for companies that donate surplus food to recognized charitable organizations. Moreover, tax deductions could allow these companies not only to offset the value of donated food against local taxes but also to reduce their overall tax burden. Local authorities can also use tax revenues to improve logistical infrastructures, facilitating the collection and distribution of donated food by establishing and funding local centers for food surplus management. Additionally, they can repurpose and renovate existing, underutilized infrastructures in various municipalities to support food surplus collection and distribution.

To achieve these objectives, optimize resources, and enhance the value of local products, it may also be necessary to strengthen public-private partnerships by offering fiscal incentives for collaborations between local supermarkets and zero-mile producers.

However, given the procedural complexities that typically characterize such measures and especially to ensure their greater effectiveness,[19] regulations should be developed to streamline the donation process, primarily through bureaucratic simplification, while maintaining strict food safety standards.

Local authorities could further support these efforts by raising the community awareness through information campaigns that highlight the benefits of food donations and the importance of reducing food waste as a civic duty. Educating companies involved in the food sector on effective food

more expensive than the recommended diet, with variations according to area; in particular, the South is the area where the difference between the two diets is greatest.

19 Gabriella De Maio, "La tutela dell'ambiente fra amministrazione, economia e fisco," in *Scritti per Franco Gaetano Scoca*, vol. 2 (Napoli: Edizioni Scientifiche, 2020), 1661–90.

surplus management practices could increase food security and promote growth in environmental,[20] social,[21] and ethical sustainability.[22]

The analysis of the diverse issues related to Food Income reveals its significant potential impact on the environment,[23] particularly in its societal dimension. Society can be seen as a meta-system of interconnected ecological and social structures that form a cohesive whole greater than the sum of its parts. Therefore, a comprehensive analysis must consider the environment, the food industry, and consumers as a unified system, from the production process to the identification of lasting solutions.

From the perspective of an increasingly circular economy, reinterpreting "waste" as a "resource" signifies a transformative shift[24] in thinking that promotes sustainability and improves the health of less affluent citizens.

For some time now, tax experts have been focusing on the human aspect of taxpayers, and in this context, increasing attention has been given to nutrition, as evidenced by the still-unimplemented Italian sugar tax project.[25] Moreover, viewing individuals in their collective and social dimen-

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20 Massimo Basilavecchia, "La tutela ambientale: profili tributari," *Rivista trimestale diritto tributario*, no. 4 (2019): 753.

21 Dario Stevanato, *La giustificazione sociale dell'imposta. Tributi e determinabilità della ricchezza tra diritto e politica* (Bologna: Il Mulino, 2014), 340; Gianluca Selicato, "Profili teorici e lineamenti evolutivi degli strumenti agevolativi a carattere fiscale e non fiscale per la promozione dello sviluppo sostenibile," *Rivista Diritto Tributario Internazionale*, no. 2 (2004): 399.

22 Franco Gallo, "La funzione del tributo ovvero l'etica delle tasse," *Rivista Trimestrale diritto pubblico*, no. 2 (2009): 404; Vittorio Emanuele Falsitta, *Fiscalità etica* (Milano: Università Bocconi Editore, 2006), 80.

23 Pietro Selicato, "Imposizione fiscale e principio chi inquina paga," in *Rassegna tributaria*, no. 4 (2005): 1157; Caterina Verrigni, "La rilevanza del principio comunitario 'chi inquina paga' nei tributi ambientali," *Rassegna tributaria*, no. 5 (2003): 1614; Stefano Dorigo and Pietro Mastellone, *La fiscalità per l'ambiente attualità e prospettive della tassazione ambientale* (Roma: Aracne, 2013), 48.

24 Antonio Felice Uricchio, "I tributi ambientali e la fiscalità circolare," dissertation supplemented with notes to the Unions of Civil Chambers conference held in Rome on 17 March 2017, "Il diritto a tutela dell'ambiente," *Diritto e pratica tributaria*, no. 5 (2017): 1860–1: "The so called linear taxation, dominated by the principle of tax neutrality so as not to influence the decisions, preferences and behavior of taxpayers and businesses, loses sight of extra-fiscal purposes in order to attribute relevance only to those of revenue, giving the state resources to spend, without regard to the merits of the uses, thus too often ending up financing spending for spending's sake and thus even wastage".

25 Specifically, the effectiveness in the pursuit of the extra-tax purpose of the sugar tax is to limit and prevent damage to consumers' health by incentivizing more informed purchasing

sions requires greater consideration of the link between the environment and health, assessing its consequences for public health. This broader perspective underscores the wide range of opportunities that measures such as the Food Income can represent for tax policy, demonstrating its flexibility and heterogeneity in terms of expertise and practical solutions.

This discussion also ties into the latest political analyses of Italy's differentiated autonomy project. While the recently approved Calderoli Decree has raised concerns about potentially worsening existing social and economic disparities, it also brings attention to untapped tax instruments that could be effective in advancing the goals of the Food Income initiative. The doubts surrounding the Calderoli Decree necessitate a deeper reflection on how taxes can support the goals of initiatives like Food Income: evaluating the role of local taxes in environmental policy[26] and in viewing waste as a resource, offers a way not only to give local taxes[27] a new "sustainable" identity but also to reduce social inequalities.[28]

5. A Comparative Analysis of Anti-waste Policies in the European Context

In the European context, from a fiscal perspective, there is no uniform legislative framework to guide individual countries in the reuse of food sector leftovers. However, European institutions increasingly recognize that tax incentives are currently the most effective tool for encouraging food donations and, recently, the issue of VAT on food donations has gained prominence in European discussions. Furthermore, the European Commission has clarified that tax barriers should not hinder food donations, recommending that VAT values be adjusted based on an assessment of the products at the time

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choices, for further study see: Antonio Felice Uricchio, "Fiscalità alimentare e circolare: problemi e opportunità a seguito dell'introduzione di sugar tax e plastic tax," *Diritto e giurisprudenza agraria alimentare e dell'ambiente*, no. 1 (2020): 185–212.

[26] Roberta Alfano, *Tributi ambientali. Profili interni ed europei* (Torino: Giappichelli, 2012), 111; Franco Picciaredda and Pietro Selicato, *I tributi e l'ambiente* (Milano: Giuffrè, 1996); Peter Lacy, Jakob Rutqvist, and Beatrice Lamonica, *Circular economy dallo spreco al valore* (Milano: Egea, 2016), 22.

[27] Andrea Giovanardi, *L'autonomia tributaria degli enti territoriali* (Milano: Giuffrè, 2005), 6.

[28] In addition, the Essential Levels of Benefits and Services, which must be uniformly guaranteed throughout the national territory as they pertain to collective civil and social rights, should also be taken into account.

of donation. This indicates a growing awareness at the supranational level of the importance of facilitating rather than restricting these functional measures.

That said, it is important to acknowledge that Italy is not the only country committed to introducing laws aimed at reducing food waste. In fact, one of the most exemplary cases is France. In February 2016, France has introduced Law No. 138, which incentivizes food donations by large supermarkets and prohibits the destruction of unsold food products. This obligation was later extended to mass catering and the food industry, while in commercial catering, the practice of imposing hefty fines for destroying unsold food was consolidated to promote the use of doggy bags.[29]

Similarly, in 2022, the Budapest Parliament approved a procedure to combat food waste, specifically targeting large foreign supermarket chains by mandating that they donate expiring food, thus supporting Hungarian-owned market players.[30]

The most recent example at the European level is the Spanish law approved in June 2022, which requires restaurants to provide leftover meals in disposable containers to any customer who requests them. Shops are also mandated to promote the consumption of organic, seasonal, or local products and to create special sales channels for products with defects. Moreover, if food is deemed unfit for consumption, it is first redirected for animal use, and if reuse is not feasible, it is repurposed for compost or biofuels. The Spanish law also imposes fines on violators, targeting restaurants that fail to comply with the rules and supermarkets that do not engage in food reuse programs. More generally, at the European level, food waste is a pervasive issue shared by all member states, though it manifests differently across regions.[31]

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[29] In this regard, in early 2024, a bill was introduced in Italy to make doggy bags mandatory for shopkeepers to provide to all customers who request them.

[30] Mario Aulenta, "Ambiente: piccoli tributi crescono," *Rivista di diritto finanziario e scienza delle finanze*, no. 1 (2020): 71; Antonio Perrone, "Fiscalità ambientale per l'Europa. Profili di diritto dell'Unione Europea," in *La fiscalità ambientale in Europa e per l'Europa*, ed. Adriano Di Pietro (Bari: Cacucci Editore, 2016), 39–44; Fabio Marchetti, "I presupposti della tassazione ambientale," *Rassegna Tributaria*, no. 1 (1999): 116.

[31] The country with the highest per capita wastage is Cyprus, with 369 kilograms of food wasted per inhabitant in 2020. It is contrasted by Slovenia, with 68 kilograms per capita.

Approximately 55% of food waste is generated by households, averaging 70 kilos per capita, while the remaining 45% occurs within the food supply chain. The "No Time to Waste" report estimates the cost of food waste at €143 billion annually, an amount made even more significant by the fact that 33 million people in the EU cannot afford a quality meal every other day. Since 2016, the European Union has been working[32] on initiatives to reverse this trend and in 2019, with the introduction of the European Green Deal[33] and the Farm to Work strategy, Brussels confirmed its commitment to halving per capita food waste by 2030. To achieve this goal, decisive actions will be taken not only by facilitating food donations but also by simplifying food labeling, eliminating the ambiguity between "best before" and "use by" labels, and introducing a contingency plan to ensure food supply and safety.

An analysis of the various European regulations on food income reveals the current fragility of Italy's national system. The delays and frequent postponements in implementing such fiscal tools are symptomatic of a broader vulnerability, the solution to which lies in a paradigm shift that should include the design and adoption of common circular economy laws at the European level, which give practical, rather than purely theoretical, value to the circular economy.

This discussion is also connected with the ongoing legal debate on environmental taxation, which has faced significant challenges in clearly defining what constitutes an environmental tax and in justifying such a tax based on the principle of the ability to pay. Indeed, the recent pandemic crisis has highlighted the urgent need for a unified European fiscal policy, which is directly linked to the issues discussed earlier in this article. The climate, economic and social changes analyzed point to the need for "a new European tax system which, preserving the fiscal responsibilities of individual states, provides both the states and the EU with the resources

[32] Agostino Ennio La Scala, Federica Pitrone, and Rossella Miceli, "La dimensione europea dell'ambiente e della fiscalità ambientale," in *I nuovi elementi di capacità contributiva* (Roma: Aracne, 2018), 13.

[33] Gianluca Selicato, "La fiscalità ambientale in Europa," in *La fiscalità ambientale in Europa e per l'Europa*, 83.

necessary to effectively exercise their respective powers."[34] This is the only way to achieve greater clarity, uniformity, and effectiveness in the individual measures taken by the Member States. On the other hand, as the Italian writer Italo Calvino points out in one of his most famous novels: "only after knowing the surface of things it's possible to look for what is underneath. Nevertheless, the surface of things is inexhaustible."[35]

6. Conclusions

Nowadays, as has been observed, the food sector is marked by a diverse array of interests, which are not always easily harmonized and, furthermore, related to a variety of fundamental goods and rights.

Given the sector's unique characteristics and the complex issues it frequently encounters, especially in light of ongoing emergencies, it is essential to develop a range of public policies aimed at providing concrete solutions. A formal legal framework for the sector is now needed to address the regulatory expectations of social systems; in fact, the emerging interests must be aligned with the various public and private stakeholders involved along the supply chain.

Enhancing food and nutrition security through targeted regulatory and fiscal policies can drive innovation, knowledge, sustainability, and inclusivity throughout the food chain, as outlined in the Commission's Communication: A Farm to Fork Strategy for a Fair, Healthy, and Environmentally-Friendly Food System (COM/2020/381 final). This approach aims to increase the sustainability of the entire food chain, starting from Southern Italy and extending to have impacts at the national, European, and international levels.

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[34] Proceedings of the conference "Nuove prospettive della fiscalità europea e applicazioni interne" (University of Naples Federico II, January 2022).

[35] Italo Calvino, *Palomar* (Italy: Einaudi, 1983), 88.

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Regulatory Developments on Sustainability Issues in Light of Delegated Regulation (EU) 2023/2772 (ESRS)

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Abstract: Sustainability reports have undergone significant evolution with the implementation of Directive 2022/2464 (CSRD). Despite the standardization efforts through the European Sustainability Reporting Standards (ESRS) developed by EFRAG, in 2023, the European Commission proposed significant reductions in reporting requirements, with cuts of up to 50%. This step back in the requirements has caused uncertainty about the CSRD's ability to ensure effective environmental sustainability reporting. The changes, formalized in Delegated Regulation (EU) 2023/2772, represent a turning point in regulating corporate sustainability, and their adequacy in achieving transparency and comparability objectives continues to be a matter of debate.

1. Introduction

A sustainability report, formerly known as the Non-Financial Information Statement (NFIS), represents an evolution in reporting aspects that go beyond mere financial accounting, promoting more responsible and sustainable corporate behavior.

Legislation in this area has advanced rapidly, culminating in December 2022 with the introduction of Directive 2022/2464,[1] known as

[1] European Parliament and Council of the European Union, Directive (EU) 2022/2464 of 14 December 2022 amending Regulation (EU) Nº 537/2014, Directive 2004/109/EC,

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the Corporate Sustainability Reporting Directive (CSRD). In March 2023, Spain took steps towards adopting this new law by drafting a preliminary bill[2] to implement the suggested changes; however, internal electoral processes stalled the progress.[3] While it appeared that Spain would lead the change in this area, France took the lead by transposing the directive into its domestic law in December 2023.[4]

The legislation before the CSRD, established by Directive 2013/34/EU,[5] did not require the preparation of an EINF, leaving its adoption at the discretion of companies. It was recognized that financial statements alone might not adequately reflect the actual economic situation of companies. The obligation for these reports was introduced by Directive 2014/95/EU[6] (Non-Financial Reporting Directive, NFRD), aiming to improve information transparency and comparability. However, efforts to achieve these goals were initially futile.[7] The lack of an adequate regulatory framework

Directive 2006/43/EC and Directive 2013/34/EU, as regards corporate sustainability reporting, accessed July 30, 2024, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32022L2464.

2 Spain, Anteproyecto de Ley xx/202X, de xx de xxxxxx, por la que se regula el marco de información corporativa sobre cuestiones medioambientales, sociales y de gobernanza, accessed July 30, 2024, https://portal.mineco.gob.es/RecursosArticulo/mineco/ministerio/participacion_publica/consulta/ficheros/APL_informacion_corporativa.pdf.

3 Elisa García Jara, José Muñoz Jiménez, and Antonio Prado Martín, "El informe sobre sostenibilidad en España, contenido y verificación," in *Medidas financieras, fiscales, sociales y procedimentales para la sostenibilidad*, eds. María Amparo Grau Ruiz, Eva Gil Cruz, Á. Falcón Pulido, and V. Martínez Torres (Aranzadi, 2024).

4 France, Ordonnance n° 2023–1142 du 6 décembre 2023 relative à la publication et à la certification d'informations en matière de durabilité et aux obligations environnementales, sociales et de gouvernement d'entreprise des sociétés commerciales, accessed July 30, 2024, https://www.legifrance.gouv.fr/loda/id/JORFTEXT000048519395/.

5 European Parliament and Council of the European Union, Directive 2013/34/EU of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC, accessed July 30, 2024, https://eur-lex.europa.eu/eli/dir/2013/34/oj.

6 European Parliament and Council of the European Union, Directive 2014/95/EU of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups, accessed July 30, 2024, https://eur-lex.europa.eu/eli/dir/2014/95/oj.

7 Virginia Martínez Torres, "Análisis de las deficiencias en la normativa sobre los Estados de Información no Financiera," Asociación Española de Contabilidad y Administración de

allowed companies to limit their reports to "selected GRI indicators" based solely on their interpretation of needs, maintaining the voluntary nature of the reported sustainability information.

With the CSRD, sustainability reports must be included in the consolidated annual accounts, creating a link between financial and non-financial reporting, emphasizing their relevance to the market and the economy, thus supporting the green transition and highlighting the crucial role of investors and sustainable finance. In this context, the European Union tasked the European Financial Reporting Advisory Group (EFRAG) with developing the European Sustainability Reporting Standards (ESRS)[8] aimed at standardizing reported information, thereby facilitating the comparability of non-financial data.

Initial drafts of the reports were disseminated in November 2022, followed by a detailed analysis to identify areas in need of improvement. Nevertheless, in July 2023, the European Commission proposed a 25% reduction in reporting requirements. In August 2023, a new Delegated Act Proposal[9] was presented, suggesting significantly reduced disclosure requirements from 25% to 40% or, in some cases, up to 50%. This proposal also removed the requirement to include a wide range of content based on indicators initially proposed by EFRAG in the reports. Subsequently, in December 2023, Delegated Regulation (EU) 2023/2772[10] was enacted, whose terms are consistent with the provisions previously mentioned in the proposal of the delegated act.

This critical analysis focuses on assessing whether the recent regulations, which seem to set a transitional phase, are adequate for effective

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Empresas, 2022, accessed July 30, 2024, https://aeca.es/wp-content/uploads/ixjor/36e.pdf.

8 European Financial Reporting Advisory Group (EFRAG), "The First Set of ESRS – The Journey from PTF to Delegated Act," accessed July 30, 2024, https://www.efrag.org/lab6.

9 European Commission, Commission Delegated Regulation (EU) 2023/2465 of 17 August 2023 supplementing Regulation (EU) Nº 1308/2013 of the European Parliament and of the Council as regards marketing standards for eggs, and repealing Commission Regulation (EC) Nº 589/2008 C/2023/5509, accessed July 30, 2024, https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:L_202302465.

10 European Commission, Commission Delegated Regulation (EU) 2023/2772 of 31 July 2023 supplementing Directive 2013/34/EU of the European Parliament and of the Council as regards sustainability reporting standards, accessed July 30, 2024, https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:L_202302772.

reporting on environmental sustainability. Furthermore, this article aims to foster an academic dialogue on a topic that, despite its relevance, has not yet been widely explored in the legal field, resulting in very limited literature on this subject.

2. Aspects Related to Sector Analysis and Specific Requirements

2.1. Criteria for Materiality Determination and Temporal Perspective

The ESRS represent three main categories: cross-cutting, thematic and sectoral. Cross-cutting standards are mandatory in terms of their development and publication. The sectoral ones are still pending publication, and the thematic ones are subject to a rebuttable presumption based on whether the company, through its double materiality analysis, considers it relevant to report this information. The thematic standards include environmental categories such as climate change, pollution, water, marine waste, biodiversity and ecosystems, natural resources, and circular economy.[11]

We have chosen to classify thematic standards as voluntary, as their application depends on the relevance the company attributes to each issue in its double materiality analysis. This allows for the omission or reduction of previously mandatory information considered essential in the CRSD, thus weakening the regulatory impact on these thematic areas through the delegated regulation.

Understanding how the relevance of an issue is determined is crucial to grasping the concept of double materiality. Materiality is based on information that could influence stakeholders' decisions about the company. Double materiality considers two dimensions: materiality in terms of impact and in financial terms (or internal). Materiality in terms of impact refers to the potential environmental effects of the company in the short, medium, and long term. These timeframes are defined in paragraph 77 ESRS 1[12] as short-term, the period of publication of the financial statements (annually); medium-term, up to five years; and long-term, more than five years. However, paragraph 80 of ESRS 1[13] allows companies to adapt these time

[11] Ramón Bastida and Pablo Verdugo. *Normas europeas de Información de Sostenibilidad (NEIS): Guía de aplicación práctica*. Barcelona: Profit Editorial, 2023.

[12] European Commission, Commission Delegated Regulation (EU) 2023/2772, (77).

[13] Ibid., (80).

horizons to their specific characteristics, leading to greater subjectivity in the decision to include environmental information as material, avoiding or postponing the preparation of thematic reports on this matter. In the case of negative impacts, in materiality in terms of impact, it is crucial to analyze the magnitude, scope, and irreparable nature of these impacts. Financial materiality refers to how the environment affects the company, assessing the likelihood of negative events occurring and the potential significance of their financial effects.[14]

This high subjectivity in determining what constitutes material information introduces considerable variability in the quality and consistency of sustainability reports presented. While this flexibility may seem beneficial to companies, allowing them to tailor reports to their specific circumstances, it poses significant challenges for stakeholders, who rely on this information to make informed decisions. In this sense, the lack of uniformity in sustainability reports makes it difficult for investors, regulators, and other stakeholders to effectively compare environmental performance between companies, which may lead to erroneous assessments of risk and corporate sustainability. This situation is exacerbated by allowing companies to discretionarily determine what information is relevant, resulting in the possible omission of critical data on negative environmental impacts and reducing the overall transparency of the reports. This reduction in transparency not only affects stakeholders' ability to make accurate assessments but can also damage the perception of the company's integrity and responsibility. Additionally, subjectivity in reporting can erode stakeholders' trust, who expect clear and complete reports that faithfully reflect the environmental challenges and risks companies face. These reporting practices can put companies at a strategic disadvantage compared to those that adopt stricter and more uniform standards, better aligning with global expectations of

[14] Transparency regarding time horizons is required in relation to the impacts and the anticipated financial effects, as set out in parts c) and e) of paragraph 48 of SBM-3 of ESRS 2: c) Details on how significant incidents affect people or the environment, their origin in relation to the business strategy, the time horizons of these incidents, and the company's involvement in them through its activities or business relationships; e) The estimated future financial impacts of risks and opportunities in financial terms over the short-, medium-, and long-term, considering risk management strategies, investment and divestment plans, and anticipated funding sources.

transparency and corporate responsibility, but in no case will they improve the overall transparency and comparability of companies or sectors.

This situation is like walking a tightrope between clouds of transparency and mists of concealment, where each discretionary step can dangerously sway the bridge of trust between companies and their stakeholders.

2.2. Standards and Specifications in Thematic Disclosure According to the ESRS

As discussed, determining materiality is crucial, especially because the disclosure of environmental information under the thematic ESRS on the environment is not mandatory when a company decides it is not materially relevant. In such situations, the company may limit itself to briefly explaining why it considers the issue not materially important. However, in the case of the ESRS E1 related to climate change, a more detailed justification is required as stipulated in IRO-2 of the ESRS 2,[15] but its submission is not enforced.

This flexibility represents a turning point for the original expectations of these regulations, as the assessment of environmental impact was considered fundamental since the 2013 Directive, which was also maintained in Directive 2464/2022.[16] Even the EFRAG had contemplated the mandatory evaluation of Scope 3 emissions for all companies. However, we now face the possibility that, under certain circumstances, information on aspects that should be considered, in our opinion, materially relevant may not be reported. This change could lead companies to prepare less detailed

15 Directive (EU) 2022/2464, 37.

16 "If companies are required to prepare a non-financial statement, this statement must include, regarding environmental issues, detailed information on the current and foreseeable effects of the company's activities on the environment, and, where relevant, health and safety, the use of renewable and/or non-renewable energy, greenhouse gas emissions, water use, and air pollution" in European Parliament and Council of the European Union. Directive 2014/95/EU, (7). "There is clear evidence that many companies do not provide significant information on all important sustainability-related topics, particularly climate-related information, such as total greenhouse gas emissions and factors affecting biodiversity. The report also noted as significant problems the limited comparability and reliability of sustainability information. Moreover, many companies from which users need sustainability information are not required to present it. Therefore, there is no doubt that a robust and accessible reporting framework, accompanied by effective audit practices, is needed to ensure the reliability of the data and to prevent greenwashing and double counting" in Directive 2022/2464 , (13).

analyses in this area, and over time, we will see how verifiers react to these situations, and we will be able to assess the effectiveness of their oversight.

2.3. Breakdown by Sectors and Associated Requirements

Directive 2464/2022 acknowledges the inherent diversity across various sectors affected by its provisions, emphasizing the need to tailor sustainability reports to reflect each sector's specificity. This customization allows for a more detailed assessment of associated risks and effects, enhancing their comparability and utility to stakeholders.

The directive explicitly highlights the relevance of this information for various interested parties, particularly regarding comparability across different market sectors and within each industry. This comparability is crucial for investors seeking to better understand companies' sustainability positions and performance and for a more accurate evaluation of companies' development, outcomes, and status. Transparency in these areas is essential to bridge the gap between companies' books and market values, taking into account sustainable elements.[17] The directive suggests that sustainability disclosure regulations should detail both universal information applicable to all entities and information particularly relevant to each company's operational scope. This approach is vital in sectors with high sustainability risks or significant environmental impacts.[18] The European Commission has committed to considering the extent of risks and impacts in each sector through specific delegated acts, as providing detailed and tailored information is deemed essential for progress towards a more sustainable future, recognizing that the diversity of risks and opportunities requires a response tailored to each sector's unique circumstances.[19]

The recently enacted delegated regulation, which complements the CSRD, specifies in the European Sustainability Reporting Standards (ESRS) 2, section 40, an obligation for companies to disclose essential

17 Ibid., (9).

18 "Las comparaciones entre empresas del mismo sector son especialmente valiosas para los inversores y otros usuarios de la información sobre sostenibilidad. Por consiguiente, las normas de presentación de información sobre sostenibilidad deben especificar tanto la información que deben divulgar las empresas de todos los sectores como la información que deben divulgar las empresas en función de su sector de actividad", ibid., (53).

19 Ibid., Article 29b-1.

information on how sustainability issues influence their overall strategy. Section b) requires a detailed breakdown of total revenues as presented in the financial statements, segmented by the significant sectors identified in the ESRS.

This mandate adds significant depth by requiring entities to segment their income by relevant sectors. This effort to clarify how sectoral operations impact and are impacted by sustainability significantly enhances transparency. Companies are encouraged to align this income segmentation with what is reported under the International Financial Reporting Standard (IFRS) 8 on Operating Segments, thus promoting greater cohesion and understanding of the information.[20] However, the application of this guideline has raised doubts among corporations, which have sought advice from EFRAG on the precise definition of "significant sectors." The confusion stems from the European Commission's lack of explicit sector classification in the ESRS. Given this uncertainty, EFRAG has indicated that, in the absence of a delegated act clarifying this point by the European Commission, companies appear not to be obligated to comply with the stipulations in section b) of ESRS 2, paragraph 40.[21] Although EFRAG clarifies that its guidance is unofficial, it assumes no responsibility for the content or consequences of following its advice.[22]

This circumstance reveals a temporary regulatory vacuum and a disconnect between legislation and its implementation. It highlights an urgent need for precise instructions that allow entities to properly adhere to

[20] IFRS 8 requires companies to report financial information in a segmented manner, which allows users of the financial statements to evaluate the performance of different parts of the company and better understand how these segments contribute to the overall performance. This level of detail helps investors, analysts, and other stakeholders to obtain a clearer view of the company's operations and its sustainability across different sectors of activity. The mention of the need to harmonize income segmentation with what is reported under IFRS 8 indicates that entities must strive to integrate these guidelines with their existing accounting practices to ensure consistency and clarity in the disclosed financial information. This cohesion is crucial for users who seek to understand not only financial performance but also how the company's sustainability practices affect or enhance this performance in specific sectors. Cf. Instituto de Contabilidad y Auditoría de Cuentas (ICAC), "Norma Internacional de Información Financiera 8, Segmentos Operativos," accessed July 30, 2024, https://www.icac.gob.es/node/717.

[21] Commission Delegated Regulation (EU) 2023/2772, (40, b), ESRS 2).

[22] EFRAG, "ESRS Implementation Q&A Platform, Explanations 1/2024".

their reporting obligations. This situation underscores the imperative need for the European Commission, with support from bodies like EFRAG, to develop and publish a comprehensive list of ESRS sectors, ensuring that companies can meet reporting requirements effectively and contribute to the ultimate goal of promoting sustainable practices. This challenge can be interpreted as a result of hasty decisions to minimize compliance requirements and European legislators' significant lack of diligence. The rush to cut demand criteria not only complicates this process for companies but also highlights haste that is counterproductive to the business ecosystem, showing a lack of foresight and care in policymaking that significantly impacts sustainability management.

2.4. Guidance on Entity-Specific Information

Within the ESRS framework, as already pointed out, certain disclosure requirements are classified into three categories: cross-sectional, thematic, and sector-specific. However, the regulation acknowledges that certain incidents, risks, or opportunities may not be detailed with the necessary depth. In such cases, companies are expected to take the initiative to supplement the reports with entity-specific information. This additional information seems essential for stakeholders to gain a clear and complete understanding of how sustainability issues affect the company, covering any gaps that may exist in the cross-sectional and thematic guidelines.[23]

As more detailed sector-specific standards are formulated and adopted, the obligation for companies to disclose specific information about their entity is expected to decrease. The reason is that these sector-specific standards (still under development) are designed to provide more comprehensive coverage, thereby minimizing potential gaps.[24] However, it is essential to note that the CSRD does not establish a specific classification for addressing this type of information, merely allowing its inclusion

[23] European Commission, Commission Delegated Regulation (EU) 2023/2772, 10.1.

[24] Directive (EU) 2022/2464, (33). The second mention of the need to provide specific information serves as a reminder that the Commission must detail it in relation to the forthcoming sectoral regulations, which were expected to be published by June 30, 2024. However, on April 29, 2024, the Council announced that the adoption of these regulations is expected to be postponed by 2 years, until June 30, 2026.

without providing further details.[25] On the other hand, the delegated regulation introduces a transitional provision regarding entity-specific information. This raises questions among those subject to these rules due to its "relatively new" character, as it was not explicitly delved into in the original directive.

The recommended strategy to address possible unspecified areas of relevance is to rely on established reporting frameworks or standards, such as the sectoral guidelines of IFRS (formerly known as SASB Standards) and the GRI Sector Standards. These resources provide crucial guidance for identifying and effectively communicating relevant information. However, it is striking that, in contrast to earlier versions proposed by EFRAG, the number of references to established norms that promote standardization has decreased. Moreover, there is no in-depth focus on specific criteria for standardizing the indicators in reporting externalities. This situation appears to be at odds with the fundamental objectives of Directive 2464/2022, which are focused on ensuring transparency and comparability.

It is crucial to consider the comparability among companies within the same sector to ensure the utility and relevance of the specific information provided. This involves a balance between giving unique entity details and maintaining consistency with general reporting parameters, ensuring that the information is both relevant and comparable. Despite requests for specific examples from companies about what might constitute this additional information, EFRAG's response highlights the situational nature of these requirements, indicating that future sector-specific standards, still under development, promise to address these sector-specific sustainability issues with greater precision.[26]

We believe that this not only complicates the reporting process for companies but could also dilute the effectiveness of the CSRD.

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[25] Virginia Martínez Torres, "Desentrañando la CSRD: balance de expectativas y realidades en el ámbito Financiero y Tributario," *Quincena Fiscal*, no. 1–2 (2024).

[26] EFRAG, "ESRS Implementation Q&A Paltform, Explanations 1/2024".

3. Challenges and Particularities of Transitional Measures

3.1. Special Provisions for Companies with Fewer than 750 Employees

The implementation of the CSRD was initially set for January 5, 2023, with the first sustainability statements expected in 2024, following this timeline: from January 1, 2024, companies with more than 500 employees, previously subject to the NFRD, will be required to present their reports in 2025; from January 1, 2025, large companies not previously subject to the NFRD, but with more than 250 employees and/or revenues over 40 million euros and/or total assets over 20 million euros, will be required to present their reports in 2026; the process will begin on January 1, 2026 for small and non-complex credit institutions, as well as for listed SMEs, which will have the option to voluntarily exclude themselves until 2028.[27]

However, Appendix C of the ESRS 1 presents an apparent contradiction by allowing companies with fewer than 750 employees to omit emissions, pollution, water, biodiversity, and resource use data. This exemption appears misaligned with the previous requirements of the NFRD, under which companies were already required to include this information in their sustainability reports. For example, the thematic standard ESRS E1–6, detailing gross greenhouse gas (GHG) emissions for scopes 1, 2, and 3, as well as total GHG emissions, allows companies or groups with an average of fewer than 750 employees at the end of the fiscal year to omit information on scope 3 emissions and total GHG emissions in the first year of sustainability reporting. Notably, this also contradicts what is stipulated in the CSRD, which considers it essential to disclose detailed information on various categories of scope 3 emissions.[28]

Similarly, the ESRS E4 covers all disclosure requirements related to biodiversity and ecosystems. It allows companies or groups that do not exceed 750 employees at the end of the fiscal year to exclude this information for the first two years of preparing their sustainability report. The CSRD highlighted the importance of this information, criticizing its omission

27 Ibid., 64–5.
28 Ibid., 47.

and demanding its inclusion within a coherent and accessible framework,[29] which was also a requirement under the NFRD.

Appendix C of the NEIS 1 also introduces provisions allowing companies, regardless of size, to omit certain essential information in their early years of sustainability reporting:

- NEIS E1–9: addresses anticipated financial effects of significant physical and transition climate risks and related opportunities. In the first year, companies may omit the required information and, for the first three years, may opt to provide qualitative rather than quantitative information if the latter cannot be prepared.
- NEIS E2–6: covers anticipated financial effects of incidents, risks, and pollution-related opportunities. In the first year, this information may be omitted. For the first three years, qualitative data may be provided instead of quantitative, except for certain details on expenses and significant cases.
- NEIS E3–5: refers to the anticipated financial effects of incidents, risks, and opportunities related to water and marine resources. The information required by NEIS E3–5 may be omitted in the first year. Companies may comply in the first three years by providing only qualitative information.
- NEIS E4–6: addresses the anticipated financial effects of incidents, risks, and opportunities related to biodiversity and ecosystems. In the first year of reporting, the required information may be omitted. Companies may opt to disclose only qualitative information for the first three years.
- NEIS E5–6: focuses on the financial effects of incidents related to the use of resources and the circular economy. Companies may omit this information during the first year, opting to present qualitative data for the first three years.

The EFRAG emphasizes the importance of reporting if the issues covered by these thematic standards have been identified as materially relevant.[30] If so, companies are required to provide, for each significant issue, a list of relevant matters, a description of how the business model and

[29] Ibid., 51.
[30] EFRAG, “ESRS Implementation Q&A Paltform, Explanations 1/2024”.

strategy of the company consider these incidents, established goals and progress towards these, related policies, actions taken to address adverse incidents, and relevant parameters for these matters.
However, the waiver of mandatory reporting of financial effects, as allowed under the provisions of Appendix C of NEIS 1, could hinder the practical application of the double materiality criteria in internal financial terms. This flexibility in disclosure may lead to companies not conducting a comprehensive analysis of the financial impacts of their activities on sustainability, resulting in a lack of preparedness to identify and report material issues according to specific regulations. Consequently, the lack of a mandatory requirement to study and report on these financial impacts may result in a voluntary, albeit transitional and transitory non-reporting of thematic reports due to the widespread absence of a materiality study, which poses a significant challenge.

From our perspective, these measures are not sufficient. Although practical for small companies, the flexibility granted by the transitional provisions could dilute the expected rigor and completeness of sustainability reporting. This is worrying, especially when some of these data were already reported under the previous NFRD framework and recognized as essential in the CSRD. Without adequate compensatory measures, this reduction in content and requirements could be a step backward rather than a step towards greater transparency and corporate accountability.

It is thus paradoxical that, while seeking to broaden the scope and depth of sustainability reporting through the CSRD, exceptions are introduced in the ESRS that limit this ambition. Failure to fully acknowledge the importance of continuity in reporting on certain topics, especially those previously covered under the NFRD, could detract from the efforts of companies that have already taken significant steps towards integrating environmental sustainability into their reporting.

3.2. Greenhouse Gas Emissions: Harmonization of GHG Accounting for Subsidiaries and Holding Companies

One of the queries raised with EFRAG is whether subsidiaries of a parent company and the parent company itself should use the same criteria and methodology for calculating and reporting GHG emissions in their consolidated sustainability reports. This is important to ensure that all information

presented is consistent and comparable both within the corporate group and for external stakeholders. According to the ESRS, both the parent company and its subsidiaries must adhere to guidelines ensuring high-quality reporting. This includes being clear and consistent about the methodologies used to calculate GHG emissions, as well as any significant assumptions behind these calculations. This is specified in several sections of the ESRS, such as Appendix B of ESRS 1[31] and paragraph 77 of ESRS 2,[32] which require detailed disclosure of the methodologies used. According to the standard, although the ESRS allow for some flexibility in the methodologies used by different companies within a group, maintaining the quality standards of the information is crucial. If different methodologies are used, these differences must be clearly explained and justified in the report in order to maintain transparency. EFRAG states that this is essential to ensure that sustainability reporting is reliable and that reported GHG emissions are comparable and understandable.[33]

In our view, even if all companies report their GHG emissions in metric tones of CO2 equivalent, given that no calculation methodologies are imposed, using different methodologies to calculate these emissions can significantly affect comparability and potentially "camouflage" significant differences in the reported results. Comparability problems in reporting GHG emissions can arise due to different emission factors used by various companies, even when reporting in the same metric unit. For example, one company may use more up-to-date or regionally specific emission factors, making its emission figures appear more favorable compared to another company or subsidiary using less specific data. In addition, methodologies for calculating scope 3 emissions vary significantly, as they include all indirect emissions in a company's value chain. These variations in methodology and underlying assumptions in calculation models, such as product lifetime or process energy intensity, can result in significant discrepancies in reported data. To address these problems, adopting and following internationally recognized standards such as the GHG Protocol, which were

31 Ibid., 30.
32 Ibid., 55.
33 EFRAG, "ESRS Implementation Q&A Platform, Explanations 1/2024".

advised in previous drafts issued by EFRAG[34] and which help minimize differences in methodologies.

The permissibility in the choice of methodologies for calculating GHG emissions within the same corporate group introduces a significant challenge not only in terms of comparability between different companies (a situation already criticized over the years by the doctrine), but also within the same corporate entity. This flexibility can lead to inconsistencies in sustainability reporting between subsidiaries and the parent company, creating a patchwork of data that will make it challenging to have a clear and consistent understanding of the environmental impact of the company as a whole. Previously, the difficulty in comparability was mainly between different companies, which already presented a considerable obstacle for investors and other stakeholders seeking to assess and compare the environmental performance and sustainability of companies. Now, by allowing different methodologies within the same group, the problem is compounded, potentially diluting the effectiveness of sustainability reporting as a transparency tool. This could lead to a lack of clarity on how environmental impacts are actually managed at the corporate level, making it more difficult for stakeholders to make informed assessments and potentially affecting trust in the company.

Transparency and consistency in environmental reporting are crucial to meeting the expectations of regulators, investors, customers and society

[34] "Calculation guidance AR 39. When preparing the information for reporting GHG emissions as required by paragraph 41, the undertaking shall: (a) consider the principles, requirements and guidance provided by the GHG Protocol Corporate Standard (version 2004 or the latest one) and GRI 305 (version 2016 which is directly based on the requirements of the GHG Protocol). The undertaking may consider the requirements stipulated by ISO 14064–1:2018. If the undertaking already applies the GHG accounting methodology of ISO 14064–1: 2018, it shall nevertheless comply with the requirements of this standard (e.g., regarding reporting boundaries and the disclosure of market-based Scope 2 GHG emissions); (b) disclose the methodologies and emissions factors used to calculate or measure (c) include emissions of CO2, CH4, N2O, HFCs, PFCs, SF6, and NF3. Additional GHG may be considered when significant; (d) use the most recent Global Warming Potential (GWP) values published by the IPCC based on a 100-year time horizon to calculate CO2eq emissions of non-CO2 gases; and (e) disclose the methodologies and emissions factors used to calculate or measure GHG emissions, and provide a reference or link to any calculation tools used"; EFRAG, "DRAFT EUROPEAN SUSTAINABILITY REPORTING STANDARDS. ESRS E1 Climate change," 31–2.

at large, and any action that compromises these principles represents a step backward in efforts towards greater corporate sustainability.

4. Conclusions

Our analysis highlights the need to standardize and normalize the information collected in sustainability reports, which would improve its management, subsequent controls, and usefulness. Unfortunately, the recent trend towards reducing the stringency of sustainability reporting has been a step backward, moving us away from previous progress made under the NFRD and complicating progress towards greater corporate transparency and accountability. Although the CSRD attempted to address some challenges, the exceptions introduced by the ESRS may compromise the expected breadth and depth of sustainability reporting. These limitations risk undermining the efforts of companies that make progress in integrating environmental considerations into their reporting, discouraging continuous improvement. A sound regulatory framework and effective auditing practices are more crucial than ever.[35]

Prof. Dr Grau Ruiz underlines the importance of reliable data for effective fiscal policies promoting fair taxation and sustainable development. Opening the horizons of sustainability reporting with appropriate tools could support the environmental fiscal framework and strategic initiatives such as the Green Deal Industrial Plan.[36]

Thus, the effectiveness of these regulations will depend to a large extent on the diligence with which each member state transposes and implements these rules. The individual efforts of each country will be decisive in maintaining and enhancing transparency and comparability. The challenge is ensuring that European regulations not only respond to academic and

35 Maria Amparo Grau Ruiz, "The Alignment of Taxation and Sustainability: might the Digital Controls of Non-Financial Information Become a Universal Panacea?," *Review of European and Comparative Law* 50, no. 3 (2022): 3.

36 European Commission, "Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions: A Green Deal Industrial Plan for the Net-Zero Age" COM/2023/62 final, accessed July 30, 2024, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52023DC0062.

market demands but also transform corporate sustainability management effectively and permanently.

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The Role of Local Government in the Process of the Brownfield Regeneration – Case Study of Košice, Slovakia

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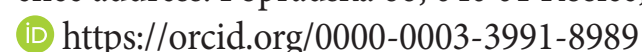
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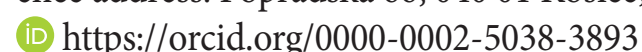
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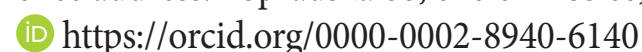
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Abstract: Many enterprises were created during the process and steps of societal changes related to industrialization. Currently, we are undergoing further development and again changes, during which the established enterprises have been closed, and unused spaces have been left behind. The issue of brownfields is increasingly becoming more and more relevant. It is in everyone's interest to use the potential of any area at the highest possible level. Brownfields offer several opportunities for overall revitalization using existing buildings. The main aim of this article is to analyze the status and possibilities of revitalizing brownfields in the city of Košice from a local government perspective. It also includes an optimal global model that covers the basic elements of subprocesses necessary for the local government's revitalization of brownfields. The research results

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illustrate that identifying these objects generates a wealth of new information useful in understanding the current state of brownfields in Košice. This new knowledge can subsequently contribute to the quality of public administration's public space management, the redevelopment of urban sites, and the improvement of urban life for everyone.

1. Introduction

Definitions of brownfield sites are various. Some authors state that there is a lack of consistent, general, or uniform interpretation of the concept of brownfield.[1] Brownfields are connected to places, lands, and areas that are underused and forgotten because of the risk of contamination,[2] or the factor of contamination or pollution may not be strictly present.[3] Sometimes, the term brownfield is also used for a degraded area, defined as a wasteland, abandoned, or ecologically affected area that has lost its previous use.[4] The most frequently mentioned term is derelict, abandoned land in the context of land that cannot be revitalized without a remedial intervention.[5] However, the weak point of the above definition was noted by Pagano and Bowman,[6] who concluded that abandoned land has no one accepted definition. This is because (as mentioned above) there are various brownfield definitions, which vary in different countries, at different levels

1 Luis Loures and Eric Vaz, "Exploring Expert Perception towards Brownfield Redevelopment Benefits According to Their Typology," *Habitat International* 72 (February 2018): 66–76, https://doi.org/10.1016/j.habitatint.2016.11.003.

2 Environmental Law Institute, "Brownfields Basics," accessed May 21, 2024, https://www.eli.org/brownfields-program/brownfields-basics.

3 Jakub Černík, "Současná Východiska Výzkumu Brownfields," XVIII. Mezinárodní Kolokvium o Regionálních Vědách. Sborník Příspěvků. Sborník Příspěvků. 18th International Colloquium on Regional Sciences. Conference Proceedings, 2015, 532–3, https://doi.org/10.5817/cz.muni.p210-7861-2015-71.

4 Slovak Environment Agency, "Degrades Areas," accessed May 21, 2024, https://www.sazp.sk/zivotne-prostredie/starostlivost-o-zivotne-prostredie/degradovane-uzemia.

5 Georgiana Popescu and Roberto Patraşcoiu, "Brownfield Sites – between Abandonment and Redevelopment Case Study: Craiova City," *HUMAN GEOGRAPHIES – Journal of Studies and Research in Human Geography* 6, no. 1 (26 May 2012): 92.

6 Michael A. Pagano and Ann O'M. Bowman, "Vacant land in cities: An urban resource," accessed May 21, 2024, https://www.brookings.edu/wp-content/uploads/2016/06/paganofinal.pdf.

of public administration, and due to each such site's distinct and unique conditions.

The European Environment Agency defines a brownfield site as "land within the urban area on which development has previously taken place."[7] On the EU level, brownfields started appearing in the agenda around 1999 in the European Spatial Development Perspective.[8] Interestingly, the keyword "brownfield" is not included in this document, but it mentions the underused sites and the necessity of their restructuring.[9] Further, they were integrated into the cohesion policy and other strategic documents; brownfield revitalization is part of steps and policies related to urban sustainability development.[10]

1.1. Brownfields in the Slovak Republic

The significance and position of brownfields in Slovakia's functional and urban spatial structure are covered by the Ministry of Environment of the Slovak Republic and the Slovak Environment Agency (in the context of the sustainable development of cities). The Agency covers sustainable spatial development for spatial planning and construction in the Slovak Republic. The main strategic documents include the Concept of Territorial Development of Slovakia, the Concept of spatial development of the region, Microregion land–use plan, Land–use plan of a city or village and Zoning plan.[11]

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7 European Environment Agency, "Brownfield Site," accessed 17 May 2024, https://www.eea.europa.eu/help/glossary/eea-glossary/brownfield-site.

8 Manca Krošelj, Tomaž Pipan, and Naja Marot, "Are EU Policies for Brownfield Redevelopment? A Case Study of Alpine Industrial in the Context of Small and medium-Sized Towns," *Urbani Izziv* 33, no. 1 (2022): 94, https://doi.org/10.5379/urbani-izziv-en-2022-33-01-03.

9 European Commission, "European Spatial Development Perspective: Towards Balanced and Sustainable Development of the Territory of the European Union," Publications Office of the EU, 23, accessed May 13, 2024, https://op.europa.eu/en/publication-detail/-/publication/a8abd557-e346-4531-a6ef-e81d3d95027f/language-en/format-PDF/source-287285340.

10 European Environment Agency, "Urban Sustainability in Europe – Avenues for Change," accessed May 13, 2024, https://www.eea.europa.eu/publications/urban-sustainability-in-europe-avenues; United Nations, Department of Economic and Social Affairs, "Desertification, Land Degradation and Drought," accessed May 13, 2024, https://sdgs.un.org/topics/desertification-land-degradation-and-drought.

11 Act on spatial planning of 27 April 2022, Journal of Laws 2024, No. 200, § 18(3).

Slovakia is one of the countries influenced by the change in the socio-economic system after phases of a centrally planned economy. The socialist economy was followed by a market economy when several enterprises closed, especially in the heavy, chemical, engineering or mining industries. They left behind large, unattractive, and ecologically damaged sites.[12] In the context of these changes, we have other topics – underdeveloped regions, which have been unable to adapt to the new challenges following the change and new opportunities.[13] If we put these two sides together, they have one common element – the lack of flexibility in responding to a change in the economy. Both are persisted to date and are obstacles to economic development. This is why we need to look at the brownfield issue in a wider context of sustainable spatial development.

This article is concerned with the local level and attempts to approximate the relationship between brownfields and spatial development. If there are many abandoned places in the city or country, it is difficult to say that this area is becoming more and more developed and prosperous. Rather, in the long term, it is a sign that the local government does not care so much about developing the territory it is supposed to manage.

Currently, we are facing another turning point in our society: demographic trends, urban densification, and rural depopulation. Indeed, each of these issues can and is considered separately, but on the other hand, cooperation with wider stakeholders is necessary. If more and more people want to live in or near a city, we must solve the housing issue (for example, in 2023 in Slovakia, more than 52% of the population lived in the cities, and more than 48% in the rural areas).[14] This is just another example of how the revitalization of abandoned buildings can meet the housing needs

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12 Bohuslava Gregorová et al., "Transforming Brownfields as Tourism Destinations and Their Sustainability on the Example of Slovakia," *Sustainability* 12, no. 24 (17 December 2020): 4, https://doi.org/10.3390/su122410569.

13 Zuzana Beňová, "Analysis of Provided Financial Support to the Least Developed Districts with Regard on Situation on Labour Market," *Ekonomické Rozhľady – Economic Review* 50, no. 3 (22 September 2021): 314, https://doi.org/10.53465/er.2644-7185.2021.3.312-329.

14 Statistical Office of the Slovak Republic, "Age composition – SR, regions, counties, districts, urban, rural," accessed May 19, 2024, http://statdat.statistics.sk/cognosext/cgi-bin/cognos.cgi?b_action=cognosViewer&ui.action=run&ui.object=storeID%28%22i40A03AF2150C41DE8BE98D0C0C41A764%22%29&ui.name=Vekov%C3%A9+zlo%C5%BEenie+-+SR%2C+oblasti%2C+kraje%2C+okresy%2C+mesto%2C+vidiek+%5Bom7009rr%5D&-

of a city. Urban densification is a topic not only in Slovakia but also in the EU. It is also closely connected with the efforts to use built-up areas. Therefore, the goal is to use the space that is already built up and not to encroach upon "greenfields".[15]

Brownfields pose challenges for policymakers on national and regional levels and for the wider surrounding area. In addition to policymakers, brownfield revitalization should also involve urban planning and environmental experts. The overall direction and economic policy must also be considered.[16] We can conclude that these aspects are the starting points. When they fail, they cause problems in such areas as finance, lack of methodology, and lack of understanding in defining the roles and responsibilities of participants.[17] Insufficient financing and municipalities not including revitalizations of their sites in the budget are also current topics linked to inconsistencies in economic policy. Missing comprehensive methodological frameworks and misunderstanding defining the participants' tasks mean revitalization is often not a priority. In general, there is a low level of cooperation and collaboration across all stakeholders. That is why this article aims to identify the current situation and simultaneously propose a model that could eliminate the above shortcomings, mostly in the methodology area.

run.outputFormat&run.prompt=true&cv.header=false&ui.backURL=%2Fcognosext%2Fcps4%2Fportlets%2Fcommon%2Fclose.html&run.outputLocale=sk.

15 Slovak Environment Agency, "Degraded Areas," accessed May 18, 2024, https://www.sazp.sk/zivotne-prostredie/starostlivost-o-zivotne-prostredie/degradovane-uzemia.

16 Detlef Grimski and Uwe Ferber, "Urban brownfields in Europe," *Land Contamination & Reclamation*, no. 9 (1), (2001), 143–148. https://www.researchgate.net/publication/228865814_Urban_brownfields_in_Europe.

17 Vladimír Koudela, Vítězslav Kuta, and František Kuda, "The Effect of Brownfields on the Urban Structure of Cities," *Slovak Journal of Civil Engineering*, no. 4 (2004), 26, accessed May 22, 2024, https://www.svf.stuba.sk/buxus/docs/sjce/2004/2004_4/file3.pdf.

2. Research Materials and Methods

The research includes a literature search of the issues under study at home and abroad and the analysis of a database of brownfield sites in urban areas. To identify the status and number of degraded areas in Košice, the indicator of the status and protection of biodiversity is applied. This indicator evaluates the location and number of brownfields in cities. It is modified to meet the research's main objective by median and temporal comparison (2015–2024) of the number of brownfields. Based on primary research, obstacles to the regeneration of brownfields and their urban potential are mapped. The study result is the proposal of an optimal model of revitalization and evaluation of the mapping of degraded areas in the city of Košice, with a proposed assessment scale of the status of degraded areas in Slovak cities so that they can be revitalized, also with the help of financial resources from the EU Structural Funds and reused. The model uses the Eriksson–Penker notation. This step will considerably strengthen not only the city of Košice but also other cities, as the main regional representative in Slovakia, and at the same time, eliminate the pressure on taking agricultural land and building on "greenfields".

3. Research Results

Košice is the metropolis of eastern Slovakia and the second most populous city in Slovakia, with almost 230,000 inhabitants. The city is part of the Košice agglomeration with 367,000 inhabitants and the Košice – Prešov agglomeration with more than 555,000 inhabitants. These figures put Košice among the largest urbanized areas in Slovakia. Urbanization brings a higher concentration of population in cities and urban areas, which causes problems related to socio-economic development. The biggest challenges are in housing and associated civil facilities.[18]

The following figure shows the Territorial plan of Košice and urban districts.

[18] "Self-Governing Regions of Slovakia," The Association of Self-Governing Regions of Slovakia, accessed March 17, 2024, https://www.samospravnekraje.sk/en/home-english/.

Figure. 1. Maps of the city of Košice. (The author's resources, Štatistický úrad SR, 2002)[19]

3.1. Indicator of Status and Protection of Biodiversity

This indicator assesses the area and number of degraded areas, i.e. brownfields, in Slovak cities based on their mapping and revitalization status. The size of the built-up area is an important attribute in terms of possibilities

[19] Territorial Plan of Košice, accessed May 11, 2024, https://www.enviroportal.sk/eia/detail/uzemny-plan-mesta-kosice.

for further use because, in many cases, the revitalization budget depends not only on the condition of the building but also on the size of the buildings, their built-up area and number of storeys, etc. By applying this indicator, adapted to the research needs, we can analyze how many degraded areas are in Košice. The reason for inclusion in the mapping of brownfields is the period of disuse of at least two years.

In Košice (Fig. 1), we found 39 brownfields based on the presented methodology of identification and inventory of brownfield sites. The total area of brownfields in Košice is 306.04 ha, which is 1.3% of the total area of the city within its administrative boundaries. In 2015, 26 brownfield sites were identified in Košice, which represented 0.98% of the total area of the city. In the long term, there is a clear trend of an increase in the number of brownfield sites in Košice between 2015 and 2024. The increase represents an increment of 13 new brownfield sites. The average value of the number of brownfields in individual locations of the city of Košice has increased from 1.18 in 2015 to 1.77 in 2024. This indicates that the average size of brownfields is growing. However, the trend is significantly differentiated by individual district urban districts (I–IV). The mapping of degraded buildings in each urban location in Košice is illustrated in Figure 1.

The first attribute studied was the spatial differentiation of brownfields in Košice according to territorial units. Based on this criterion, we can observe an uneven distribution of brownfield sites (Fig. 1). Out of a total of 22 localities (or even municipalities), it is possible to identify brownfields in only 8 (Sever, Sídlisko Ťahanovce, Ťahanovce, Juh, Západ, Staré Mesto, Nad jazerom, Myslava). The largest number of brownfields is located in Staré Mesto (15 BF). Thus, most brownfield sites in Košice are strategically placed in the city center. However, these sites are unused in terms of the city's urban potential. In the last 9 years, the number of brownfields in the central part of Košice has increased by 6 rather than decreasing or possibly having been regenerated. The increase of degraded sites is also in the urban parts of Košice, i.e. Nad jazerom, Juh, Myslava. On the contrary, the number of brownfields has decreased over the last 9 years in the Košice localities of Dzungla, Západ, Sídlisko KVP.

The data analysis shows a significant increase in the number and size of brownfield sites in Košice between 2015 and 2024. This trend indicates the growing importance of managing and revitalizing these brownfield sites

in urban planning. At the same time, however, it is evident that there are significant differences in the size and number of brownfield sites between different locations in the city, which requires a differentiated approach to their management and use.

Table 1. Mapping of degraded buildings in urban parts of Košice

Urban parts	Number	Number	Trend		Hectare	Total area (ha)
	2015	2024	2024		2024	2024
Košice II – Západ	3	1	II	↓	2.41	553
Košice III - Dargovských hrdinov	0	0	III	–	0	1109
Košice IV – Nad jazerom	2	7	IV	↑	47.28	366
Košice II – Sídlisko KVP	2	0	II	↓	0	178
Košice IV – Juh	5	9	IV	↑	30.00	977
Košice I – Sídlisko Tahanovce	1	1	I	–	18.22	826
Košice I – Staré mesto	9	15	I	↑	19.41	434
Košice I – Sever	2	2	I	–	164.26	5458
Košice II – Luník IX	0	0	II	–	0	107
Košice II – Šaca	0	0	II	–	0	4121
Košice IV – Krásna	0	0	IV	–	0	2005
Košice IV – Barca	0	0	IV	–	0	1813
Košice III – Košická Nová Ves	0	0	III	–	0	577
Košice IV – Vyšné Opátske	0	0	IV	–	0	419
Košice I – Tahanovce	1	1	I	–	0.30	728
Košice II – Myslava	0	3	II	↑	24.16	701
Košice II – Pereš	0	0	II	–	0	133
Košice I – Kavečany	0	0	I	–	0	1005
Košice II – Poľov	0	0	II	–	0	1296
Koišce II – Lorinčík	0	0	II	–	0	297
Košice IV – Šebastovce	0	0	IV	–	0	510
Košice I – Džungľa	1	0	I	–	0	47
Total	26	39		↑	306.04	23,660
Median	1.18	1.77		↑		

Source: The author's draft based on data from SAŽP, 2024.

It is important to develop effective strategies for the use of these spaces to strengthen the city's urban potential and contribute to its sustainable development. Cooperation with the public and the involvement of other stakeholders in the planning and regeneration of brownfield sites is crucial for the successful implementation of these measures and for achieving positive urban and social changes in the urban environment.

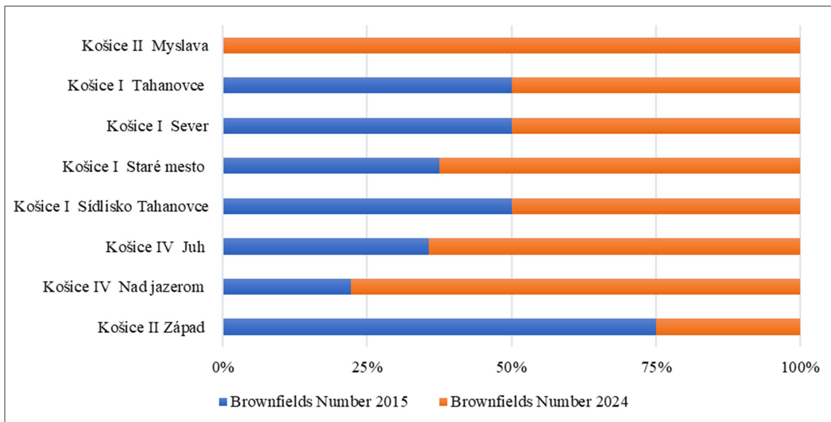

Figure. 2 Number of brownfields in % of analyzed urban parts of Košice between 2015 and 2024. (The author's resources, 2024)

The success of brownfield regeneration depends on several factors such as location, environmental conditions, potential for future use, ownership, and the existence of infrastructure[20]. Based on this, we further analyzed these selected factories in the city of Košice in our study and illustrated in Table 2 our scale of evaluation of the degree of degraded areas into 3 basic levels. This division characterizes the status and condition of the site, and the degree of degradation of buildings and surrounding areas.

[20] Hamil Pearsall, "Superfund Me: A Study of Resistance to Gentrification in New York City," *Urban Studies* 50, no. 11 (14 March 2013): 2293–310, https://doi.org/10.1177/0042098013478236.

Table 2. Mapping of degraded areas according to the degree of degradation in Košice

Košice	**1 Weak degradation**	**2 Moderate degradation**	**3 High degradation**	**Total**
	Facilities and objects abandoned but preserved	*Facilities and objects partially dilapidated*	*Facilities and objects devastated*	
Západ	–	–	1	1
Nad jazerom	–	4	3	7
Juh	5	1	3	9
Sídlisko Ťahanovce	1	–	–	1
Staré mesto	5	5	5	15
Sever	2	–	–	2
Ťahanovce	2	–	1	3
Myslava	1	–	–	1
Total	**16**	**10**	**13**	**39**

Source: The author's resources, 2024.

From the mapping of the degree of degradation in Košice and its individual urban parts, it is clear that the largest number of brownfields occurs in the category of weak degradation (16), moderate degradation (10), and high degradation unsuitable for regeneration (13). The largest number of degraded sites is in the Stare Mesto, where there are 15 objects, of which 5 represent the category of weak, 5 moderate, and 5 high degradation. Another location with a significant number of degraded buildings is Košice-Juh, where there are 9 buildings, of which 5 are weakly degraded, 1 is moderately degraded, and 3 are highly degraded. The other locations have fewer degraded objects or none at all.

In Table 3, we evaluated the degraded objects in the city of Košice according to property relations. Objects are divided into four categories according to the type of property relations: settled with a small number of owners, settled with many owners, and unsettled. The number of objects corresponding to the type of property relations is provided for each

category. The total number of properties in each location and the total number of degraded properties in the city are also given.

Table 3. Mapping of degraded objects according to property relations

Košice	1 Settled with a small number of owners	2 Settled with a large number of owners	3 Unsettled	Total
Západ	1	–	–	1
Nad jazerom	4	3	–	7
Juh	6	3	–	9
Sídlisko Ťahanovce	–	1	–	1
Staré mesto	14	–	1	15
Sever	2	–	–	2
Ťahanovce	2	1	–	3
Myslava	1	–	–	1
Total	**30**	**8**	**1**	**39**

Source: The author's resources, 2024.

From the analysis, it is clear that ownership relations in the possible regeneration of brownfields are not an obstacle to their implementation in Košice. Out of the 39 mapped brownfields, up to 30 are settled with a small number of owners. This represents 77% of the objects with settled property relations. On the other hand, 20% of the settled land plots in Košice have a large number of owners, and 3% are unsettled land plots located only in Staré Mesto.

In Table 4, we mapped the degraded objects in Košice according to the availability of infrastructure. The objects are divided into three categories according to the level of infrastructure accessibility: good accessibility, moderate accessibility, and difficult accessibility. For each category, the number of objects that correspond to the given level of infrastructure accessibility is provided. In addition, the total number of objects in each location and the total number of degraded objects in the city are given.

Table 4. Mapping of degraded objects according to infrastructure availability

Košice	**1 Good accessibility**	**2 Moderate accessibility**	**3 Difficult availability**	**Total**
Západ	1	–	–	1
Nad jazerom	7	–	–	7
Juh	9	–	–	9
Sídlisko Ťahanovce	1	–	–	1
Staré Mesto	15	–	–	15
Sever	2	–	–	2
Ťahanovce	3	–	–	3
Myslava	1	–	–	1
Total	**39**	**0**	**0**	**39**

Source: The author's resources, 2024.

This attribute characterizes the transport infrastructure near the degraded site and its potential to be connected to road infrastructure. The results show that all degraded objects in Košice have good transport accessibility and are thus suitable for revitalization. Therefore, transport infrastructure cannot be considered a problem in the removal and revitalization of brownfields in Košice.

In Table 5, we mapped the degraded objects according to natural and architectural values.

The buildings are divided into two categories: those with historical and heritage value and those without historical, architectural, or other value. The number of objects corresponding to that type of value is given for each category. The total number of buildings in each location and the total number of degraded buildings in the city are also listed. There are 5 objects of historical and architectural value in Košice's Juh and Staré Mesto. There are 34 objects without historical and architectural value in total. The largest number of degraded buildings is in the Stare Mesto, where there are 15 buildings, of which 4 have historical and architectural value, and 11 have no historical, architectural, or other value. Therefore, the historical and

architectural value of the objects cannot be considered a problem in the removal and revitalization of brownfields in Košice.

Table 5. Mapping of degraded objects according to natural and architectural values

Košice	Historical and heritage value	No historical, architectural, or other value	Total
Západ	–	1	1
Nad jazerom	–	7	7
Juh	1	8	9
Sídlisko Ťahanovce	–	1	1
Staré Mesto	4	11	15
Sever	–	2	2
Ťahanovce	–	3	3
Myslava	–	1	1
Total	**5**	**34**	**39**

Source: The author's resources, 2024.

It is evident from the results that the largest part of the objects requiring revitalization are located in the urban areas of Košice-Staré Mesto, Košice-Nad jazerom and Košice-Juh. The problematic aspect of the actual removal and revitalization in Košice is the degree of degradation of individual sites, which shows the status and condition of individual areas. This aspect is also crucial for the investment itself. In Košice, up to 59 % of the mapped objects fall into the category of moderately to heavily degraded, which requires increased investment.

The perception of brownfields as a territorial reserve in Košice is unquestionable. On the other hand, there is a change in the functional use of the BF area, which may not always be welcomed in the area. It is crucial to consistently apply a full-fledged urban concept to areas for all necessary functions and not only for the current use of selected sites.

3.2. The Global Model of Brownfield Revitalization for Local Governments

This model aims to create a level of abstraction of the process that enables an understanding of all its activities and their connections. Brownfield revitalization consists of a set of four interconnected subprocesses. To visualize the system's complexity, but not in great detail, a global process model has been developed by the authors of this paper. The global model is perceived as timeless and statically focused on the existing elements and their interactions.

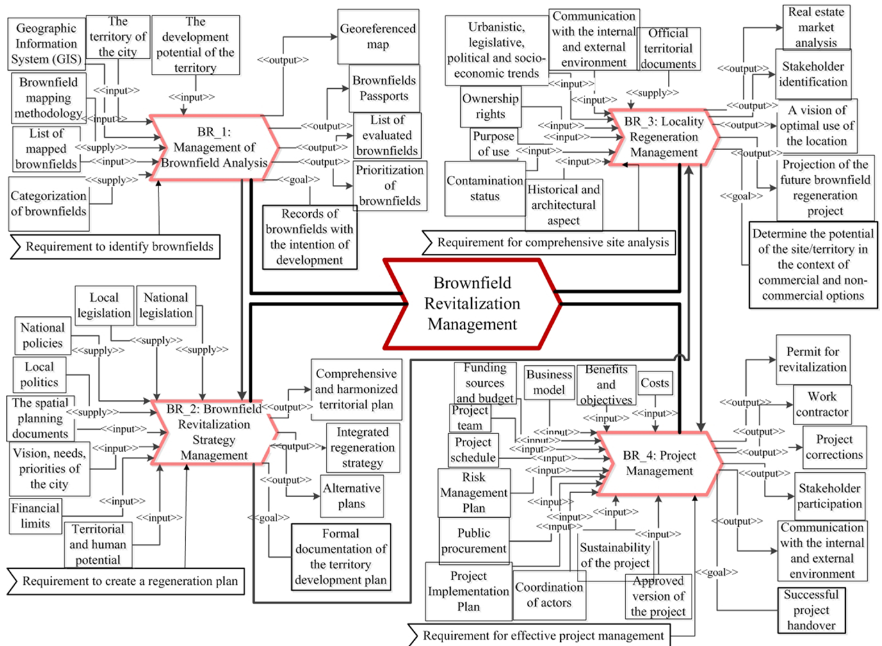

Figure. 3. Global Model of Brownfield Revitalization Management in Slovakia. (The author's resources, 2024)

Brownfield Revitalization Management consists of BR_1 Management of Brownfield Analysis, BR_2 Brownfield Revitalization Strategy Management, BR_3 Locality Regeneration Management and BR_4 Project Management. Each of the mentioned subprocesses has its own model elements,

according to H. Eriksson. It is an event, information, resources (inputs), outputs, and a goal. The global model shows a system of subprocesses and their relationships, where the outputs of a subprocess are inputs to the next subprocess. The model can be a methodical and informational tool for local government representatives responsible for developing degraded areas and the municipality in general. However, this development depends on the financial resources of the local government.[21]

4. Discussion and Conclusion

The issue of brownfields is handled marginally, within other projects and at the local level. However, if we consider international experience, it shows that the best solution is a comprehensive approach at the national level.[22] Degraded areas are most often located in historical city centers and have become new city symbols. Their revitalization could transform the functional use of the space. A degraded area is a disused, dilapidated, or environmentally affected property that has lost its original use. The main goal should be to transform degraded sites into economically productive, ecologically and socially healthy areas through coordinated efforts at all levels of government, the private sector, and non-profit organizations. The revitalization of brownfield sites should also be one of the fundamental objectives of urban development. It should be supported in many city conceptual documents, e.g. the Urban Housing Policy Concept, the Urban Master Plan, etc. However, Košice does not even have this concept defined in its strategic documents, and it is not apparent that such sites are suitable for revitalization. The definition and mapping of these objects and the method of their transformation should be the first step in solving this problem in the city. These objects could become a suitable place for an investor who would prefer them to a greenfield investment.

However, there is a significant difference in the possibilities, opportunities, and approaches to tackling this complex issue.

[21] Ivana Butoracová Šindleryová, Lukáš Cíbik, and Kamil Turčan, "Effects of Indebtedness of Self-Governing Regions: Comparison between Selected Central European Countries," *Lex Localis – Journal of Local Self-Government* 21, no. 4 (1 November 2023): 1167–200, https://doi.org/10.4335/21.4.1167-1200(2023).

[22] Slovak Environment Agency, "Degraded Areas," accessed 22 May 2024, https://www.sazp.sk/zivotne-prostredie/starostlivost-o-zivotne-prostredie/degradovane-uzemia.

Overall, this analysis shows the importance and dynamics of brownfield management in Košice, focusing on the regeneration and transformation of such sites for future use. With the continuous growth of urbanization and the spread of individual cities, the issue of brownfields, which are often in strategic locations in the city centers, as is the case of Košice, will play a major role in their further development so as to serve the needs of the city and its inhabitants.

This topic has multiple points of view, and we divided it into two groups. The first group can be conceptualized from a negative side – brownfields as a problem. For example, in our towns and cities, we have plenty of abandoned areas that are not used, and it seems that nobody cares about them. The overall look and feel of the city are also related to this – semi-dilapidated, dilapidated, or damaged buildings are part of the visual smog that no one needs. Also, the question of costs – for revitalization or also for destruction.

The second group can be considered positive – brownfields as an opportunity. The fact is that the rate of consumption is continually increasing. We all need more space to meet our needs (for example, various kinds of services, etc.). Another viewpoint with a very similar basis is related to the trends in urbanization – many people (mostly younger) prefer city life to country life – the question of housing affordability arises.

These are just a few examples. Notwithstanding the above split, it is necessary to point out that all brownfields share some characteristics – they are objects situated in a concretely geographical area in towns, cities, and self-government units. This fact should also be borne in mind by elected representatives. Of course, it is a complicated, complex, and wide-ranging issue, but city leaders should take responsibility for the area they manage. The brownfields topic cannot be avoided endlessly.

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