

ANALYSIS



Tax

Belgium in breach of the Anti-Tax Avoidance Directive by denying taxpayers the deduction of corporate income tax paid by controlled foreign companies

The Court of Justice of the European Union has ruled that Member States may not deny a taxpayer the right to a deduction from its tax liability in its state of tax residence or location of the corporate income tax paid by a controlled foreign company that, meeting the requirements, has its tax residence in another Member State or in a third country in accordance with the provisions of Article 8(7) of Directive (EU) 2016/1164.

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1. Background

Directive (EU) 2016/1164 requires Member States to lay down rules against tax avoidance practices that directly affect the functioning of the internal market. Among these, they must include rules regarding

The fight against tax avoidance or an alleged deterrent effect does not justify denying the deduction

controlled foreign companies (CFCs) that have the effect of re-attributing the income of a low-taxed controlled subsidiary to its parent company, which becomes taxable on this attributed income in the State where it is resident for tax purposes.

To carry out the tax consolidation of the income of controlled foreign companies into the taxpayer's tax base, Article 7(2), (a) and (b), of the Directive offers Member States two options: to include in the tax base certain categories of non-distributed income of the controlled foreign company—or of the permanent establishment—or to include the non-distributed income of the entity—or of the permanent establishment—arising from non-genuine arrangements put in place for the essential purpose of obtaining a tax advantage.

For its part, Article 8 of the Directive regulates the computation of controlled foreign company income. Paragraph 7 of this provision establishes that the taxpayer's Member State shall allow a deduction of the tax paid by the entity (or permanent establishment) from the tax liability of the

taxpayer in its state of tax residence or location. This deduction shall be calculated in accordance with national law.

Upon the expiration of the deadline for transposing the Directive, Belgium informed the European Commission of its national transposition measures and of its decision not to incorporate Article 8(7) of the Directive into its national law, since, pursuant to Article 3 of the Directive, a minimum level of protection is established that does not preclude “the application of domestic

or agreement-based provisions aimed at safeguarding a higher level of protection for domestic corporate tax bases”. The Belgian rule on controlled foreign companies would apply only in cases of tax fraud; therefore, it was not deemed appropriate to allow the deduction of foreign taxes.

The Commission considered that the measures adopted by Belgium did not ensure compliance with the Directive. On 2 December 2021, the European Commission issued a reasoned opinion urging the Belgian authorities to adopt the necessary measures to transpose Article 8(7) of the Directive into their domestic legal system within two months of its receipt. In light of Belgium's refusal to allow a taxpayer to deduct from its tax liability the tax paid by a controlled foreign company in the state of tax residence, the Commission decided to refer the case to the Court of Justice of the European Union.

In her Opinion of May 22, 2025, Advocate General Juliane Kokott deemed the allegation of failure to fulfil an obligation through non-transposition unfounded. However,

the Court of Justice of the European Union, in its Judgment of 26 February 2026 (C-524/23), does not share that view and upholds the Commission's position.

2. The Court of Justice's reasoning

The Court of Justice considers that the *wording* of Article 8(7) of Directive (EU) 2016/1164 clearly reflects its mandatory nature and general character—without providing for any exception to the obligation established therein—and therefore must be transposed into national law, with Member States' discretion limited solely to determining the method of calculating the deduction.

The *context* of Article 8(7) of the Directive confirms the literal interpretation. Paragraphs 3 through 7 of that provision neither establish nor make any distinction between the two options set forth in Article 7(2)(a) and (b) for incorporating the rules on controlled foreign companies into national law. Therefore, the possibility for the taxpayer to benefit from a deduction corresponding to the tax paid by such a company must be applied by the Member State of the taxpayer's residence, regardless of the option chosen by that Member State for the taxation of the income of such companies.

Article 7(2)(b) of the Directive establishes a specific rule for controlled foreign companies, applied by the taxpayer's Member State, which aims to include in the taxpayer's tax base the non-distributed income of the entity or permanent establishment derived from non-genuine arrangements put into place for the main purpose of obtaining a tax advantage. This specific mechanism constitutes a *lex specialis* that

takes precedence over the general rule against abusive practices set forth in Article 6 of Directive (EU) 2016/1164. Therefore, Member States are not free to apply to the income of controlled foreign companies derived from non-genuine arrangements established with the primary aim of obtaining a tax advantage, either through that specific anti-fraud rule or through a general rule against abusive practices that meets the criteria of Article 6 of the Directive and that excludes the possibility for the taxpayer to benefit from the deduction provided for in Article 8(7) thereof.

Similarly, Article 8(7) is consistent with the *objectives* of the Directive. The Directive aims to establish rules against the erosion of tax bases within the internal market and the shifting of profits outside it, and applies to all taxpayers subject to corporate income tax in a given Member State. Likewise, where the application of the rules set forth in the Directive results in double taxation, taxpayers must be able to benefit from a deduction for the tax paid, since those rules are intended not only to counter tax avoidance practices but also to prevent the creation of other obstacles to the internal market, such as double taxation. The purpose of Article 8(7) of the Directive is to prevent double taxation of the income of the controlled foreign company included in the tax base of the taxpayer exercising control over it, thereby preventing the creation of a new barrier to the internal market that might result from the application of those rules. Consequently, it contributes to the Directive's overall objective of *keeping a balance between the goal of countering tax avoidance practices and that of preventing the creation of other obstacles to the internal market, such as double taxation.*

Furthermore, the Court notes that taxpayers subject to corporate income tax in the Member State where they have their tax residence and who control controlled foreign companies falling within the scope of Articles 7 and 8 of the Directive, regardless of whether those companies are tax residents of another Member State or a third country, are in comparable situations in light of the criteria established in those provisions. The possible failure of Member States to apply Article 8(7) of the Directive cannot be justified by the objectives of the Directive. Taxpayers, regardless of the Member State whose tax legislation applies to them, must be able to benefit from the deduction of tax paid by a controlled foreign company provided that the requirements set forth in that provision for claiming the deduction are met.

Finally, the Court rejects the Belgian authorities' argument regarding the harmonization of minimum standards established by the Directive and the Member States' power to adopt provisions aimed at safeguarding a higher level of protection for national corporate income tax bases. The potential deterrent effect of the absence of a mechanism to prevent double taxation in the scenario covered by Article 7(2)(b) of the Directive and its potential to enhance the effectiveness of the fight against abusive tax practices do not justify the failure to transpose the deduction provided for in Article 8(7) of the Directive. In order to counteract the erosion of tax bases in the internal market and cross-border tax avoidance, it is not necessary for the income of the controlled foreign company in situations involving abusive tax practices to be subject to double taxation; it is sufficient to exclude the tax advantage sought to be obtained therefrom, thereby

circumventing the application of the national legislation of the Member State to which the taxpayer is subject.

The Court also rejects the Belgian authorities' argument that the double taxation arising in a situation such as that set forth in Article 7(2)(b) of the Directive, where goods, services, capital, and persons do not circulate within the internal market, does not actually constitute a barrier to that market. In the Court's view, the maintenance of double taxation of the income of the controlled foreign company under the application of that provision, due to the refusal of certain Member States to apply Article 8(7) of the Directive, could cause or perpetuate divergences and asymmetries in that market (which the Directive is specifically intended to correct) and would also entail unequal treatment of taxpayers (depending on the Member State whose legislation applies) that could not be justified.

Consequently, the Court of Justice finds that the Kingdom of Belgium has failed to fulfil its obligations under Directive (EU) 2016/1164 by failing to adopt the statutory, regulatory and administrative provisions necessary to comply with Article 8(7) thereof. And that the legislative changes subsequently made by Belgium (in force since 1 January 2024) cannot be taken into account for the purposes of examining the infringement, which is determined based on the situation at the end of the period set out in the Commission's reasoned opinion.

The action for failure to fulfil an obligation brought to a close by this judgment attracted particular attention due to the doubts raised regarding the Union's powers

to adopt Directive 2016/1164 on the basis of Article 115 of the Treaty on the Functioning of the European Union. Those doubts regarding legality were shared by Advocate General Kokott in her Opinion; however, in accordance with EU case law, they cannot be examined within the framework of an action for failure to fulfil an obligation.

3. Conclusions

Unlike the Belgian legislation at issue in the judgment under review, the Spanish regime of international tax transparency contained in Article 100 of the Corporate Income Tax Act 27/2014 of 27 November 27, allows for the deduction of taxes or levies of an identical or analogous nature to this tax that are actually borne abroad by investees. However, the Spanish provision precludes the deductibility of taxes borne by controlled companies resident in countries or territories classified as non-cooperative jurisdictions, even if the taxpayer demonstrates that they have been effectively paid, thereby deviating from the general regime set forth in Articles 31 and 32 of the same Act.

Furthermore, the ambiguous wording of Article 100(9) of Act 27/2014 may give

rise to double taxation in upstream dividend cases. When the imputed income of the controlled non-resident company consists of a dividend or capital gain to which the exemption provided for in Article 21 of the Corporate Income Tax Act applies, double taxation may occur, firstly, because the foreign income is attributed by applying the rule of non-deductibility of 5% of the dividend as management expenses for the equity interest, and secondly, because such income, once paid as a dividend, would be taxed again as management expenses related to those equity interests at a rate of 5% of the dividend amount.

An interpretation favouring the inclusion of 5% of the amount of the dividends in the tax base in cases of upstreamed dividends could contravene the provisions of Article 8(5) of Directive 2016/1164, pursuant to which, “[w]here the entity distributes profits to the taxpayer, and those distributed profits are included in the taxable income of the taxpayer, the amounts of income previously included in the tax base pursuant to Article 7 shall be deducted from the tax base when calculating the amount of tax due on the distributed profits, in order to ensure there is no double taxation”.