Terra/Wattel

European Tax Law

Volume I – General Topics and Direct Taxation

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PREFACE

This book is intended as a reference book for EU law and tax law practitioners, administrators, academics, the judiciary, and tax law or Union law policy makers. For students, an abridged textbook edition is available.

The present Volume I on general topics and direct taxation offers a systematic survey of the implications of the EU Treaties and of EU tax harmonization policy for national tax law, tax treaties and third State tax relations, a thorough and critical discussion of the EU Court's case law in direct tax matters, as well as a thorough discussion of the Union's direct tax rules in force and pending. Volume II of this book, on indirect taxation, was published in 2021 and covers the Union Customs Code, the Recast VAT directive, Excises and Energy taxation directives, as well as administrative cooperation in the field of indirect taxation.

The present Volume I is divided into four parts:
1. General EU Law and Taxation
2. Negative Integration of Direct Taxation;
3. Positive Integration of Corporate Taxes, and
4. Exchange of Information and Recovery Assistance.

In addition to all relevant substantive aspects of taxation, also matters of cross-border administrative cooperation, procedural matters and judicial protection are covered, including tax implications of the EU Charter of Fundamental Rights.

Apart from some last-minute additions, copy was closed in March 2025.

TABLE OF CONTENTS

CHAPTER 14

EU inheritance and gift taxation / 485

Vassilis Dafnomilis

CHAPTER 15

State Aid and Direct Taxation / 515

Sjoerd Douma

PART 1 GENERAL EU LAW AND TAXATION

CHAPTER 1

Introduction

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Update and elaboration by Otto Marres, Sjoerd Douma, Hein Vermeulen, Dennis Weber

Articles 2-6 of the Treaty on European Union (TEU) state the mission of the European Union. They enumerate, *inter alia*, the founding values of the Union, notably freedom, democracy, equality, the rule of law, respect for human rights, etc. They further state Union objectives, notably the realization or at least promotion of these values, as well as peace, the well-being of the peoples, cohesion and solidarity, and an area of freedom, security and justice without internal frontiers. More mundane objectives are a balanced and sustainable growth, price stability, full employment, social protection, competitiveness, etc. The Articles 3 and 4 TEU also mention two means to realize especially these more mundane objectives: the establishment of an internal market and of an economic and monetary union whose currency is the Euro.

An internal European market having the characteristics of one single national market requires, in particular, the free movement of goods, services, persons and capital, irrespective of national borders (Art. 26(2) TFEU), undistorted conditions of competition within that internal market (a level playing field; Arts. 101-109 TFEU), as well as harmonization of national laws insofar as disparities between national laws and administrative practices impede the functioning of that internal market (Art. 114 TFEU). The most manifest tax obstacles to the proper functioning of an internal EU market are:

- taxes on cross-border transactions, i.e. on the border-crossing of goods and services;
- differential tax treatment of domestic and imported goods and services;
- compulsory and current tax settlement of unrealized gains and other tax latencies upon the emigration of legal persons and individuals (exit taxes);
- substantial differences (disparities) between national tax laws, leading to market distortions, especially excessive tax competition between Member States facilitating tax avoidance by mobile capital;
- especially for EU-wide businesses: having to comply with up to 27 different tax administrations and 27 different sets of substantive and procedural tax law, including differences in tax accounting rules and tax timing;
- differential tax treatment of resident and nonresident taxpayers;
- differential tax treatment of domestic and foreign investment;
- differential tax treatment of domestic and foreign source income;

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– international economic double taxation (same tax base; different taxpayer), i.e. as a result of profit distributions by a company in one Member State to a shareholder in another Member State;
– International juridical double taxation (same tax base; same taxpayer) as a result of parallel exercise of taxing power by the source State and the residence State of the taxpayer (e.g. uncreditable source taxation: 'excess foreign tax credit'), or as a result of mismatches, e.g. transfer pricing differences, income characterization mismatches, tax accounting differences, etc.

Since the financial crises of 2008-2010, attention of politics has also turned to the drawbacks of free movement of capital and the freedom of establishment, especially to the resulting tax avoidance opportunities for mobile capital, and the drawbacks of not harmonizing direct taxes, especially corporate income taxes. The main drawbacks are distortive disparities (mismatches between tax systems) producing opportunities to exploit these mismatches (BEPS: base erosion and profit shifting, notably (i) double deduction, (ii) deduction without inclusion and (iii) non-taxation without inclusion) and excessive tax competition between Member States leading to 'tax degradation' (sponging on other Member States' tax revenue). Such competition may even result in prohibited State aid for multinational companies. It produces unacceptable undertaxation of mobile capital at the cost of public services.

These drawbacks obviously need to be addressed, but that does not take away the fact that tax obstacles as the ones listed cause market fragmentation along national borders which may impel (smaller) economic operators to stay on their home markets to avoid international double taxation or excessive administrative burdens, and thus may improperly affect the decisions of undertakings, employees, and (portfolio) investors as to where to trade, where to accept a job, where to establish an undertaking, where to incorporate, and where to invest. Therefore, integration of the tax systems of the EU Member States is necessary to a certain extent. Such integration may be 'negative' (market integration, *i.e.* integration through prohibitions: the abolition of restrictive national tax measures which are incompatible with the TFEU) or 'positive' (policy integration, *i.e.* integration through legislation, coordination and cooperation at Union level: harmonization of national tax laws, or at least policy coordination between Member States).

This book discusses both negative and positive tax integration in the EU. Negative integration mostly consists of case-by-case – and therefore rather unorganized – case law of the Court of Justice of the EU (CJEU, or: Court) on the (in)compatibility of national tax measures with EU free movement rights or the State aid prohibition. The discussion of positive integration of tax law covers the current harmonizing tax measures taken at Union level and pending proposals for Union action in the area of taxation, as well as EU soft law in that area.

This edition is divided into two volumes. Volume 2 covers indirect taxation and administrative cooperation in that field. The present Volume 1 covers (i) general Union law issues of importance for direct taxation, (ii) negative integration of direct taxation, (iii) harmonization of corporate taxation and (iv) administrative cooperation as regards direct taxation.

Part I (Chapters 1-5) deals with general issues of EU law, (international) tax law and (external) EU policy and the way in which general (principles of) EU law and (international) tax law interact;

Part II (Chapters 6-15) covers negative integration of direct taxes, especially the extensive body of CJEU case law – more than 350 cases – on the (in)compatibility of national tax measures and bilateral tax treaties with free movement rights and the State aid prohibition contained in the TFEU.

Part III (Chapters 16-26) discusses the current and pending EU Directives on corporate taxation, including the minimum harmonization of national and bilateral anti-abuse legislation, dispute settlement rules, soft law on tax competition and tax aspects of the European Company, the European Cooperative Company and the European Economic Interest Grouping;

Part IV, finally, covers cross-border administrative assistance in the levying and collecting of taxes, notably (automatic) exchange of tax information and recovery assistance between Member States.

Positive integration (harmonization measures and coordination at EU level) only modestly contributes to the abolition of tax impediments to the proper functioning of the internal market. Whereas most of the extensive integration of indirect taxes, especially of customs duties, turnover taxes and excises has been achieved by way of positive integration measures (EU regulations and directives), most of the integration of direct taxes is a result of prohibitions, *i.e.* case law of the CJEU holding national tax measures incompatible with primary EU law. Generally speaking, indirect taxes have been harmonized at EU level because they are a conspicuous and immediate obstacle to free trade as they are taxes on transactions: taxes on trade in, or the border-crossing of, goods and services. If one is to have free trade, there is no choice but to either abandon such taxes altogether, as is the case with taxes on the intra-EU border-crossing of goods and services (customs duties), or to harmonize them to make them internationally neutral. Direct taxes, by contrast, are taxes on the income or wealth of (legal) persons, having a less direct and less visible effect on trade and services, although one may argue they distort trade just as much as transaction taxes: unlike indirect taxes, they are not refunded upon exportation, but remain locked in the price of the goods and services exported by the economic operators.

Direct taxation is viewed by most Member States as the last hardcore part of their sovereignty within the Union, which implies little political enthusiasm for positive integration of direct taxes, as that would entail relinquishing budgetary and therefore core sovereignty. The consequence is, however, a large and rapidly expanding body of case-by-case and therefore unorganized and inconsistent case law of the Court, often fatal for the national direct tax measure at issue because it violates a free movement right or the State aid prohibition.

Because of these marked differences in legal basis (see Chapter 2) and in degree of integration between indirect and direct taxes, the CJEU's case law in indirect tax matters is different in character from its case law in direct tax matters. For indirect taxation, comprehensive and technically detailed secondary EU law has been enacted and implemented. The indirect tax cases brought before the Court therefore mostly concern implementation problems, *i.e.* the interpretation of these detailed, technical EU rules on indirect taxation. They are hardly ever on the consequences of free movement rights or the State aid prohibition. This part of EU tax law is *tax* law rather than *EU* law: the rules to be interpreted and applied are detailed and technical rules of indirect taxation, and to a much lesser extent Union law principles such as, notably, free movement, non-discrimination, proportionality, etc.

In the field of *direct* taxes, it is the other way around. Direct tax cases still rarely concern the implementation of dedicated EU legislation, although since 2017 an increase in cases on the application of the few EU corporate tax directives has been notable, as there still is little such legislation. Rather, direct tax cases before the CJEU concern the clash between the TFEU free movement rights and EU law principles on the one hand, and detailed, unharmonized domestic tax legislation and bilateral tax treaties on the other. Consequently, direct tax issues before the Court do not so much concern interpretation of *tax* law (as the Court is not competent to interpret national law or bilateral tax treaties) as they concern (principles of) *general EU* law, *i.e.* the general, sweeping Treaty rules of principle, such as free movement, market access, market equality, subsidiarity, proportionality, abuse of rights, level playing field (undistorted competition), Union loyalty, effectiveness of EU law, etc. In direct tax cases, the Court is a balancing artist between the interests of the internal market and the legitimate interests of 27 Member States to protect their separate national tax bases against base erosion, profit shifting, fiscal incoherence and (hybrid) mismatches. The national direct tax rules the Court is called upon to assess in the light of these very general principles of EU law are often extremely technical and detailed. This extreme difference in abstraction level of the two bodies of law clashing, makes negative integration of direct taxes complex and chaotic, more so because of a sophisticated third set of rules in between involved: the bilateral tax treaty network between the Member States which itself is complicated by the OECD Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (multilateral instrument or MLI) into existing bilateral tax treaties.

The TFEU contains principles which must be respected in all areas affecting the objectives of the Union, therefore also in the tax area. One of these principles is the prohibition of discrimination against goods, services, workers, undertakings and capital from other Member States, of any other discrimination directly or indirectly based on nationality of persons or on origin of goods, capital and services, and even of nondiscriminatory measures hindering free movement. This principle – and other principles, such as Union loyalty and undistorted competition – have significant consequences for national tax sovereignty. They considerably limit Member States' freedom to arrange their national tax systems in the way they see fit. The far-reaching impact on national taxation of these general (non-tax) TFEU provisions will be discussed in Chapters 2-5 (general EU law principles and concepts) and 6-15 (negative integration of direct taxation). They are especially important in direct tax matters because of the scarcity of substantive harmonization in that area and the fact that national direct tax systems tend to distinguish between domestic-source income and foreign-source income and between resident taxpayers and nonresident taxpayers, whereas the TFEU in principle prohibits differential (less favorable) taxation of cross-border investment, establishment and employment than purely domestic investment, establishment and employment. Even non-discriminatory measures (national measures not distinguishing between cross-border and domestic cases) which nonetheless make cross-border market access excessively difficult, may be incompatible with the TFEU Freedoms.

Another harmonizing factor more important in direct tax matters than positive integration, is regulatory competition between Member States. All Member States court the favors of foreign investors to attract economic activity, employment, and growth, from both third States and other Member States, *inter alia* by offering competitive company taxation legislation, individual tax rulings and advance pricing agreements (APAs) to international business. Such tax competition produces spontaneous harmonization, especially of corporate tax rates, since neighboring States with a comparable level of economic opportunity, infrastructure, social security and public services, cannot afford to diverge significantly in tax burdens, less so as the (other) obstacles to individual or corporate emigration and to cross-border economic activity have been removed. This is more so since the introduction of the Euro as a common currency, taking away currency risks of cross-border investment and employment. If Member States diverge significantly in tax burdens without offering corresponding levels of public service and economic opportunity, then mobile economic activity will move to more tax-efficient Member States. The ensuing economic and social necessity for less tax-efficient Member States to keep up with the rest of the Union is usually a more convincing argument for national tax policy makers than abstract ideas, lofty objectives, or legal principles. It is striking to see how the levels of corporation tax in the 'old' fifteen Member States in a relatively short period came down from around 40% or higher to nowadays around 20% or lower (12,5% in Ireland), especially since the accession of the twelve eastern European Member States. At the same time – as the effective tax burden is the product of the tax base (corporate income) and the tax rate – most Member States broadened their tax base (fewer deductions, fewer exemptions and fewer credits) to compensate for the lower rate, overall possibly implying only a modest reduction in effective tax burden. If most Member States are forced by each other's regulatory competition to follow this pattern, the result is a more homogeneous corporate fiscal landscape throughout the Union.

Excessive ('unfair') tax competition, however, may lead to base erosion and fiscal degradation: Member States outbidding each other to attract foreign investors, sponging on each other's tax bases. The result may be an unjustified and economically dysfunctional EU-wide loss of tax revenue, benefiting mainly those who were already very capable of looking after themselves (internationally mobile capital), at the cost of less mobile tax bases like wages, the cost of which was already higher than in the US and Asia. In order to prevent both the exploitation of mismatches by internationally mobile capital, especially big tech, and excessive tax competition between States, the OECD designed a 'Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy': Pillar 1 re-allocates taxing rights over MNEs from their home countries to their market jurisdictions, regardless of whether they have a physical presence there. Pillar 2 introduces a global minimum effective corporate tax rate of 15%. This two-pillar approach has been adopted by the OECD/G20 'Inclusive Framework', comprising 137 countries representing more than 90% of global gross domestic product (GDP). The EU Commission aimed to implement it as fast as possible in the EU; in December 2021, it tabled proposals for a Directive to prevent the misuse of shell entities for tax purposes ('Unshell'), to be effective from 1 January 2024, and for a Directive on ensuring a global minimum level of taxation for multinational groups in the Union, to be effective from 1 January 2023 (see Section 25.3). Both met with quite some political opposition. The Unshell Directive proposal is still pending; the Pillar 2 Directive is adopted on 14 December 2022 and applicable in respect of the fiscal years beginning from 31 December 2023 (see Chapter 22). Implementation of Pillar 1 will take longer (if adopted at all), as it is politically even more controversial.

Harmonization of taxes, especially of direct taxes, is politically highly sensitive. Tax sovereignty is a fundamental part of national sovereignty. One of the most basic rights of a national parliament is its budget right: the right to vote on taxes. The European Parliament cannot, as yet, be considered an adequate substitute for national democratic parliamentary control, as there are, precisely, no European taxes, *i.e.* taxes levied at EU level by an EU tax administration on the spending of which the European Parliament votes. Taxation is the most important economic and social policy instrument for national governments. It may be used to redistribute income or wealth, to encourage investments or savings, to discourage the consumption or the use of certain goods (sin taxes; Pigouvian taxes), to protect the environment, etc. Therefore, the TFEU still provides for unanimity voting on tax matters, implying that each Member State has a veto right. The more unavoidable the harmonization and, with that, the loss of national sovereignty as regards *indirect* taxation is, the less Member States are inclined to forego their remaining tax sovereignty in the field of *direct* taxation. No Member State wants its tax base to be determined by the EU, let alone its tax rate. The adoption of the Pillar 2 Directive, resulting in a minimum *effective* corporate income taxation of 15%, is a major political achievement, because it implies, to a certain extent, harmonization of the corporate tax base. Pillar 1 (partial re-allocation of MNE's tax bases to market jurisdictions) is even more controversial, as it, precisely, interferes even more with tax base determination *and* allocation and looks like a first step towards an EU system of formula apportionment of tax base to Member States.

As observed, a genuine *European* tax does not exist yet. There is no tax administrated, levied and collected at Union level by a Union tax authority – except the payroll tax on the salaries of the EU civil servants, the 'Eurocrats' – on the spending of which the European Parliament votes. A Belgian proposal in 2000 to introduce a Eurotax met with skepticism and irony. Other Member States referred to historical examples of new taxes which led to war, such as the Spanish Duke of Alva's 'tenth penny', which led to the eighty-year Dutch-Spanish war, and the British tax on tea, which through the Boston Tea Party lead to the American War of Independence. But little did they know in 2000 that it was precisely the *absence* of a fiscal and political union – to complete and bolster the monetary union – which in 2011-2012 almost lead to a budgetary war, which almost destroyed the monetary union and the Euro. The successive credit crisis, bank crisis, Euro crisis and public debt crisis revealed a serious and dangerous lack of fiscal and political integration in the hitherto very successful Euro-area. Measures have been taken to prevent such crises from happening again, but among these was not an EU tax.

For the time being, the Union will have to make do with two categories of own revenue sources. Its most important traditional 'own resources' are (i) a percentage of the national bases of value added tax, capped to a percentage of GDP, (ii) the customs duties levied at the outside borders of the EU (minus perception costs), and (iii) agricultural levies. Since the budgetary and euro crises in the first decade of the 21st century, an *ad hoc* intergovernmental stability mechanism was added, funded by national revenue contributions of which every one of the 17 Euro Member States' parliaments had to approve (leading to government changes in four of the Member States in those crisis years). In December 2021, the Commission proposed to add three own resources to the EU budget: (i) 15% of the additional tax base to be allocated to Member States by the upcoming Pillar 1 reallocation of residual profits of in-scope MNE's to EU markets; (ii) 25% of Member States' revenue from the EU CO2-emissions trading system (ETS), and (iii) the revenue from the proposed EU carbon border adjustment mechanism (CBAM) which will put a carbon price on imports from third States corresponding to what would have been paid, had the goods been produced in the EU. The Commission completed its proposal in June 2023 (see Section 25.3.4).

All of these own resources are not genuine EU taxes, however, as they are levied and collected by national tax administrations, and the revenue is transmitted to the EU. That revenue is relatively small as compared to the percentage of Member States' GDP taken by national taxation. At Union level, taxation thus plays a limited role as a policy instrument. Consequently, at present the Union hardly has a tax policy of its own. The Commission policy is one of aligning national taxes and tax policies in so far as necessary for the functioning of the internal market, eliminating discriminatory, restrictive, and protective national taxation, but also excessive tax competition and fiscal State aid, if necessary by taking Member States to Court (see Art. 258 TFEU), and encouraging Member States to use taxation as a means to further economic development, especially of small and medium-sized enterprises (SMEs) and of research and development. Since the EU 'Green Deal', environmental policy objectives have been added, to be financed by the ETS and CBAM revenues mentioned above.

To date, the largest EU law impacts on national tax systems have been, for indirect taxation, the abolition of intra-EU customs duties, the concomitant introduction of common outside border customs duties (the customs union), and the introduction of the value added tax (VAT) system with a harmonized base for all national turnover taxes. For direct taxation, they were the CJEU's case law prohibiting national tax measures which make it less attractive to work, establish or invest abroad than at home, and the adoption of a series of directives greatly extending the automatic exchange of tax information between the Member States (see Chapters 25-29). Also, for the first time in more than 20 years, the Member States in 2017 adopted substantive EU direct tax measures. Anti-abuse measures were inserted in the existing Parent-Subsidiary Directive (PSD; see Chapter 16) and adopted in a new separate Anti-Tax Avoidance Directive (ATAD; see Chapter 19). A proposal for a common consolidated corporate tax base (CCCTB) has never been adopted, however, but is now rebranded as BEFIT: the Commission's decades-long ambition to achieve a harmonized corporate income tax is still burning (see Section 25.3.6).

CHAPTER 2

Constitutional Foundations: EU Tax Competences; Treaty Basis for Tax Integration; Sources and Enactment of EU Tax Law

Peter Wattel

Update and elaboration by Rita Szudoczky[1] and Dennis Weber[2]

2.1 Division of (Tax) Competences Between the Union and the Member States

Union competence is based on the principle of conferral: the Union has only the competences conferred on it by the Member States in the founding treaties, i.e. the Treaty on the European Union (TEU) and the Treaty on the Functioning of the European Union (TFEU) (see Article 5 TEU). The competences conferred upon the Union may be divided into three categories: (i) exclusive competences (Member States are not competent any more), listed in Article 3 TFEU; (ii) shared competences with 'preemption' (both the Union and the Member States are competent, but whenever the Union exercises its competence, the Member States lose their competence in the field on which the Union has exercised its competence), listed in Article 4 TFEU; and (iii) shared competences without preemption, meaning that the Union is only competent to support, coordinate or supplement, without superseding the competence of the Member States, listed in Article 6 TFEU.

Taxation is not expressly mentioned amongst the competences listed under Articles 3 to 6 TFEU. This does not mean that the Union does not have competences in the field of taxation. On the contrary, the customs union is listed as the first area in which the Union has exclusive competence (Article 3(1)(a) TFEU). A customs union is the mundane basis of the Union's genesis. In fact, the most basic idea of the European Union is a fiscal idea. Article 28 TFEU states that 'the Union shall comprise a customs union (…).' Indeed, custom duties at the border and discriminatory taxation of foreign goods and services are blunt and conspicuous restrictions of free trade. They are flagrantly incompatible with free movement of goods and services. Therefore, elimination of trade barriers within the (then) 'Community' began with the abolition of customs duties and other import restrictions, and the harmonization of indirect taxes. A customs union implies the total prohibition,

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between the Member States, of import and export duties, of any charges having an effect equivalent to a customs duty (Article 30 TFEU), and of all quantitative restrictions on imports and all measures having equivalent effect (Article 34 TFEU). Obviously, it also implies a common customs tariff at the *outside* borders of the Union (Article 31). That common customs tariff came into force on 1 July 1968.

Furthermore, since taxation affects intra-Union cross-border trade, investment, service provision and employment, it is clearly an internal market issue. Hence, both indirect taxation – other than customs duties – and direct taxation are caught under the competence heading 'internal market' in Article 4(2)(a) TFEU, which is a shared competence with preemption: as soon as and to the extent in which the Union has exercised its competence to regulate a tax matter by way of a regulation or a directive, the Member States have, to that extent, lost their individual competences to regulate that tax matter.

The Union, incited by Article 113 TFEU (see Section 2.3.2.) to harmonize indirect taxes, has done so extensively in respect of customs duties, excise duties and turnover tax. It has used its competence as regards direct taxation to a much lesser extent, but the Anti-Tax-Avoidance Directive (see Chapter 19), the implementation of the global minimum tax in the EU (the EU Pillar Two Directive; see Chapter 22) and the reinvigoration of the idea of a common EU corporate tax system (Business in Europe: Framework for Income Taxation, BEFIT)[3] may bring the degree of – at least – corporate income tax harmonization closer to that of indirect taxation. Nevertheless, the Court of the EU (Court or CJEU) persistently emphasizes in its case law that direct taxation falls 'within the competence of the Member States,' to which it invariably adds: but they 'must none the less exercise that competence consistently with Union law,' meaning that they should respect the internal market free movement rights of taxpayers, and observe the State aid prohibition.[4]

Where the principle of conferral delimits the competences of the Union vis-à-vis Member States' sovereignty ("competences not conferred upon the Union in the Treaties remain with the Member States"), the principles of subsidiarity and of proportionality, also laid down in Article 5 TEU, regulate the *exercise* of the competences which have been conferred upon the Union. According to the principle of subsidiarity (Article 5(3) TEU):

> "…the Union shall act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States, either at central level or at regional and local level, but can rather, by reason of the scale or effects of the proposed action, be better achieved at Union level."

This unclear language and the lack of substantive interpretation by the Court makes constitutional subsidiarity a rather elusive concept.[5] The principle governs the scope of

3 Communication from the Commission to the European Parliament and the Council, Business Taxation for the 21st Century COM (2021) 251 final, Brussels 18 May 2021.

4 In the context of the free movement provisions, see for example, Case C-446/03, *Marks & Spencer*, EU:C:2005:763, point 29; Case C-196/04, *Cadbury Schweppes*, EU:C:2006:544, point 40; Case C-279/93, *Schumacker*, EU:C:1995:31, point 21. In the context of the State aid prohibition, see for example: Case C-501/00, *Spain v Commission*, EU:C:2004:438, point 123. In the context of various general EU rules and principles, see Case C-417/10, *3M Italia*, EU:C:2012:184, point 25.

5 Out of the abundant literature for a critical view, see for example Gareth Davies, Subsidiarity: The wrong idea, in the wrong place, at the wrong time, 43 *Common Market Law Review* 1 (2006), pp. 63-84.