

Comprehensive Guide to EU Tax Directives

As Chinese enterprises accelerate their expansion into Europe, understanding the EU tax framework has become critical for compliant operations. EU Tax Directives are the core instruments for coordinating the tax systems of the 27 Member States. They are legally binding, and each Member State must transpose them into domestic law. For companies going global, mastering the seven core directives is not only a prerequisite for compliance but also a powerful tool for optimizing tax burdens and mitigating risks.

I. VAT Directive

The core of the VAT Directive is to establish a unified value-added tax system, with a standard rate not lower than 15%.

The key rules mainly fall into the following three categories:

1. B2C transactions: destination principle; VAT registration is required in the country of sale;
2. B2B transactions: reverse charge mechanism, where the buyer accounts for and pays the VAT;
3. One-stop filing: VAT for the entire EU can be declared at a single point. OSS (One-Stop Shop) is a tax mechanism introduced by the EU to simplify VAT reporting for cross-border B2C (business-to-consumer) sales within the EU. This mechanism allows enterprises to declare and pay all VAT due in EU destination countries through a single registration in one Member State, eliminating the need to register in each Member State individually. After VAT

is paid to the tax authority of the Member State of registration, it is responsible for distributing the tax to the respective destination countries. IOSS (Import One-Stop Shop) is an electronic declaration system established by the EU to simplify VAT collection for low-value goods sold from non-EU countries to EU consumers. This mechanism applies to goods with a value not exceeding EUR 150 shipped directly from non-EU countries to EU consumers.

All goods entering the EU must handle import VAT. However, depending on the value of the goods and the sales model, there are two different approaches. The first scenario involves parcels shipped directly from non-EU countries such as China to EU consumers with a value not exceeding EUR 150. In this case, the seller collects VAT at the point of sale and declares it through the IOSS system, and no VAT payment is required at customs clearance. In other scenarios, IOSS is not applicable.

For warehousing and logistics within the EU, enterprises must follow the principle of taxation in the country where the warehouse is located. Regardless of where the company is registered, and regardless of whether sales are generated locally, if goods are stored in a warehouse located in an EU Member State (including Amazon FBA warehouses and third-party overseas warehouses), VAT registration in that country is mandatory. This is similar to the domestic principle of taxation at the location of immovable property.

II. Parent-Subsidiary Directive (PSD)

The core of the **Parent-Subsidiary Directive** is to eliminate withholding tax on cross-border dividends and avoid double taxation.

To qualify for this benefit, the following conditions must be met: within a parent–subsidiary relationship between EU Member States, the parent company must directly hold at least 10% of the subsidiary’s share capital and maintain such holding continuously for at least 2 years, or one party may commit at the time of receiving dividends to continue holding the shares until the 2–year period is met. Both parties must be qualifying limited liability companies and not part of purely tax avoidance arrangements. If the committing party fails to fulfill the commitment (i. e., disposes of shares within 2 years), Member States may require repayment of the exempted taxes.

Chinese companies may hold shares in other EU companies through holding companies in jurisdictions such as the Netherlands or Luxembourg, thereby enabling tax-free repatriation of dividends. The real value of intermediate holding structures in jurisdictions such as the Netherlands and Luxembourg becomes evident in multi–country structures. When a group has subsidiaries in Germany, France, Italy, and other EU countries, intra–EU dividend flows can be fully exempt, and ultimately consolidated and distributed from the Netherlands back to China.

However, intermediate holding companies must demonstrate economic substance (e. g., office, personnel, decision–making) to avoid being classified as shell companies or triggering Controlled Foreign Company (CFC) rules, which is similar to arrangements between Mainland China and Hong Kong.

III. Mergers Directive

The core of the Mergers Directive is that capital gains tax on cross-border reorganizations (mergers, demergers, asset exchanges) may be deferred.

For example, during internal restructuring within Europe, the appreciation of transferred assets does not require immediate taxation but can be deferred until future disposal, thereby reducing cash flow pressure during restructuring. Similar arrangements exist within our domestic tax system.

It should be noted that companies must file in advance with tax authorities and demonstrate commercial justification.

IV. Interest & Royalties Directive (IRD)

The core of the Interest and Royalties Directive is the exemption from withholding tax on cross-border interest and royalty payments between associated companies within the EU.

The exemption conditions require that one party directly or indirectly holds at least 25% of the share capital or voting rights of the other party for a continuous period of at least 2 years, and the recipient must be the beneficial owner. When these conditions are met, the source country does not levy withholding tax.

Under this directive, withholding tax can be reduced from 10% - 30% to 0% for qualifying enterprises. For example, it is suitable for establishing IP holding centers (e.g., in Luxembourg) to license operating companies in different countries.

Enterprises applying this mechanism must also ensure that transfer pricing complies with the arm's length principle and prepare contemporaneous documentation.

V. Directive on Administrative Cooperation (DAC6)

The Directive on Administrative Cooperation (DAC6), formally known as Directive (EU) 2018/822, is a landmark tax transparency regulation introduced by the EU in 2018. Its core objective is to combat cross-border tax avoidance. It requires intermediaries (such as accountants, lawyers, and tax advisors) and certain enterprises to proactively report cross-border tax arrangements that may carry potential tax avoidance risks to tax authorities.

The reported content is referred to as “Reportable Arrangements.” Any arrangement that meets specific “Hallmarks” must be reported. These hallmarks cover various behaviors that may lead to Base Erosion and Profit Shifting (BEPS), including confidentiality arrangements, standardized products, cross-border conversions, circular transactions, and abuse of tax treaties.

Under this regime, existing structures may be disclosed, and failure to report may result in fines of up to EUR 200,000 per case.

VI. Anti-Tax Avoidance Directive (ATAD1 & ATAD2)

The Anti-Tax Avoidance Directive is a set of mandatory rules established by the EU to combat aggressive tax planning and prevent BEPS. It consists of two main components: ATAD1 and ATAD2, which

together establish the minimum anti-avoidance standards that EU Member States must comply with.

ATAD1 focuses on five key areas:

1. Interest Limitation Rules: net interest expenses up to 30% of EBITDA are deductible in the current year; the excess may generally be carried forward to future years.
2. Controlled Foreign Company (CFC) Rules: profits of subsidiaries in low-tax jurisdictions (without substantial economic activities) must be taxed at the parent company level.
3. Exit Tax Rules: assets transferred out of the EU are taxed based on fair market value gains.
4. Hybrid mismatch rules (Transposition Clause): prevent double non-taxation arising from mismatches, such as participation exemption regimes. If a foreign company has a very low tax rate, dividends or royalties paid to an EU parent company may not qualify for exemption and may instead be taxed in the EU parent's jurisdiction.
5. General Anti-Avoidance Rule (GAAR): a catch-all provision targeting arrangements lacking commercial substance. ATAD2 further expands and strengthens hybrid mismatch rules to address gaps in ATAD1, particularly targeting complex cross-border structures that exploit differences in national tax systems.

VII. Digital Tax-Related Proposals



At the EU level, the earlier proposal for a Digital Services Tax (DST) has largely been abandoned, with a shift toward establishing new tax categories to create independent EU revenue sources. However, some Member States (such as France) continue to impose their own digital taxes.

Although the digital tax initiative has stalled, the EU has proposed other forms of taxation to increase revenue and build a “genuine EU tax system.” Examples include a levy of EUR 2 per kilogram on electronic waste, a progressive tax on large enterprises with net turnover exceeding EUR 50 million, a cross-border e-commerce parcel tax on imports from non-EU countries, and allocating a portion of tobacco tax revenues collected by Member States to the EU as a tobacco consumption tax.