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HARMFUL TAX COMPETITION
OVERCOMING UNFAIR FRUGALITY

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Abstract

Harmful tax competition is neither a recent phenomenon nor is it limited to the European economic area. The phenomenon, which accelerated through globalisation and the digital revolution, has been a cause for concern since the 1990s. Outside observers might have thought the European project and the single market would have protected Member States from such unfair practices. However, the European Union's (EU) failure to harmonise company taxation, with a few exceptions, has paved the way for the development of harmful tax competition.

It is a controversial matter. States benefiting from this competition attach importance to their fiscal sovereignty, thereby benefitting from competitive advantages and tax attractiveness for foreign investment. The other States, in favour of dismantling harmful tax systems, are faced with the unanimity rule imposed by the treaties on Council decisions in tax matters.

That said, the increase in tax scandals (the Lux Leaks, Panama Papers, Paradise Papers, etc.) is a testament to the scale of the phenomenon. Initiatives have re-emerged to combat unfair tax competition, which is indicative of a breach in solidarity between EU Member States.

1. AN INCREASINGLY DIFFICULT CONCEPT TO GRASP IN REALITY

1.1. CONCEPTS THAT FUEL THE DEBATE

1.1.1. EVASION, AVOIDANCE, AND FRAUD: A GAME OF WORDS?

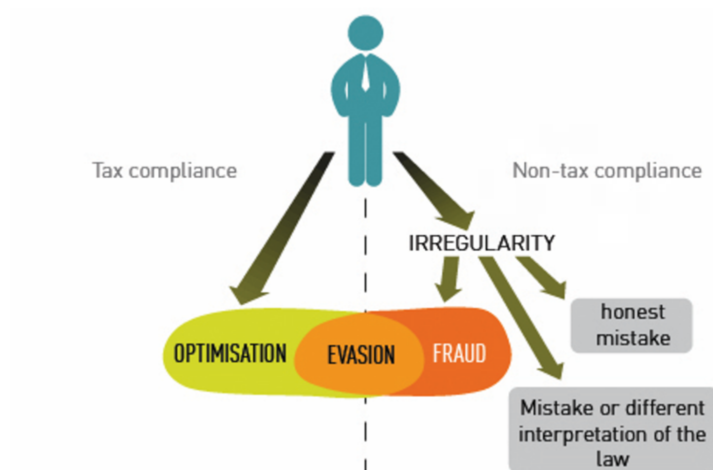
Tax evasion, avoidance and fraud are closely related concepts that are often used interchangeably. Textbook authors do not always give them the same definition, particularly with regard to tax evasion, which is the fuzziest concept.

Tax evasion results from tax avoidance and tax fraud. The *Conseil des prélèvements obligatoires* (the French Tax and Social Charges Board), defines tax evasion as *"the set of behaviours of the taxpayer aimed at reducing the amount of levies normally payable by the taxpayer.* *If it uses legal means, then tax evasion falls into the category of tax avoidance. Conversely, if they use illegal techniques or conceal the true scope of their stakeholders, evasion is akin to fraud".*

Such fuzzy boundaries in definition led the *Cours des Comptes* (France's Supreme Audit Institution) to develop four key ideas in its latest fraud report published in November 2019. The four ideas focus on tax levy avoidance:

- *tax optimisation*, which refers to the fact that a taxpayer chooses, among the possibilities offered by the law, the one that appears to be the least costly, meaning their conduct is lawful;
- - *tax evasion*, which refers to all transactions intended to reduce the amount of levies normally payable by the taxpayer, the regularity of which is uncertain;
- - *tax irregularities*, which include all forms of behaviour, whether intentional or unintentional, in good or bad faith, which reduce the compulsory levy amount; in some cases, irregularities are errors committed by the taxpayer and, in others, they constitute fraudulent behaviour;
- - *tax fraud*, as outlined in article 1741 of the French General Tax Code, which involves a deliberate and conscious violation of the regulations in force.

FIGURE 1 ▪ Tax evasion



Source: French Senate Report, tax evasion of capital and assets outside France and their tax consequences, July 2012

These definitions closely resemble those of the OECD. However, there are some slight nuances (see text box below).

BOX 1 ■ The definition of tax fraud, evasion and avoidance from the OECD*

The glossary of tax terms provided by the OECD's Centre for Tax Policy and Administration demonstrates the difficulty in categorising the three abovementioned notions. This is especially the case for tax evasion, which references both tax avoidance and tax fraud.

"Fraud: tax fraud is a form of deliberate evasion of tax which is generally punishable under criminal law. The term includes situations in which deliberately false statements are submitted, fake documents are submitted (to tax authorities), etc.

Evasion: a term that is difficult to define but which is generally used to mean illegal arrangements where liability to tax is hidden or ignored, i.e. the taxpayer pays less tax than he is legally obligated to pay by hiding income or information from the tax authorities.

Avoidance: a term that is difficult to define but which is generally used to describe the arrangement of a taxpayer's affairs that is intended to reduce his tax liability and that although the arrangement could be strictly legal it is usually in contradiction with the intent of the law it purports to follow.

Tax planning (optimisation): Arrangement of a person's business and/or private affairs in order to minimise tax liability."

1.1.2. HARMFUL TAX COMPETITION: A NEW CONCEPT THAT IS HARD TO DEFINE

Harmful tax competition is a relatively new concept. The expression came into widespread use in the OECD's report entitled "Harmful tax competition, an emerging global issue", published on 19 May 1998. The report was commissioned by OECD Finance Ministers in May 1996 and endorsed by the 1996 Lyon G7 Summit.

The report underlines that globalisation has created a new environment that may favour tax practices designed to attract foreign investment at the expense of competitor countries, distorting trade and eroding tax bases.

The report distinguishes two types of harmful tax competition: tax havens and harmful preferential tax regimes. In addition to recommendations concerning the fight against harmful tax competition, it mainly focuses on proposing a definition of each of these two forms of competition.

The OECD developed four criteria to identify a tax haven:

- No or only nominal taxes;
- Lack of transparency in tax regimes;
- Legislation that prevents the exchange of information with other governments;
- Tolerance of shell companies with fictitious activities.

Regarding the second type of harmful tax competition, the OECD categorises **harmful preferential tax regimes** as follows: concomitance of a low or zero effective tax rate with other factors such as the possibility of negotiating the tax rate or tax base, the existence of secrecy provisions to promote tax minimisation schemes and the distinction of taxation from the presence of real economic activities and jobs.

Upon reading the criteria, it is possible to assume the EU does not practice unfair and harmful competition. Analytically speaking, that would be a mistake. For governments deprived of control over monetary and exchange rate policy, taxation remains the only directly accessible instrument for boosting the attractiveness and competitiveness of their national

economies. Having retained the bulk of their fiscal sovereignty, Member States are all the more tempted to use taxation as an instrument for economic purposes. Of course, this may go against the goal of developing the single market, an area of fair competition.

The risk of a tax bidding war which would not comply with the rules of fair competition is all the greater since several features of the EU could encourage certain Member States to engage in such practices:

- The diversity of national economies, which intensified with the 2004 expansion eastward.
- The coexistence of large countries that are less dependent on the outside world and small, open countries that are more tempted to manipulate levies to offset their lack of attractiveness.
- Diverse public preferences reflecting very widely diverging levels of public spending.
- The freedom of establishment and the free movement of capital, which are guaranteed in the EU market and may stop any nationwide fight against tax evasion.

The second Monti report from October 1996[1], was based on the work of a high-level group made up of personal representatives of ministers. This report, for the most part, retains the approach and strategy used for the first report. In particular, the report underlines the need to create more favourable conditions for the development of business and to complete the internal market, without jeopardising the protection of tax bases and the prevention of fraud and cross-border tax evasion.

De facto, harmful tax competition is attributable to a few Member States that regularly hold back initiatives to eliminate unfair practices proposed by the European Commission (EC).

It is in this context that the subject of harmful tax competition is reviewed. The report notes, however, that the perception of the influence of the threat of harmful tax competition on national tax policies varies from one Member State to another and that it was impossible to draw up a common and objective definition of the concept of harmful tax measures.[2] As a result, some members of the group suggested that the Commission, in this respect, should apply, in a coherent and transparent manner, the rules governing State aid and that work in this area should be carried out in line with efforts made by the OECD. It also includes a special focus on the issue of taxation of savings.

1.2. A NEW GEO-ECONOMIC ENVIRONMENT

1.2.1. ANONYMOUS GLOBALISATION COMBINED WITH THE DIGITAL REVOLUTION

Globalisation has resulted in a fragmentation and geographical dispersion of production processes. Although, for centuries, the origin of a product and where it came from were identical, as goods were entirely manufactured in a single country, today, the true origin of a product - which determines the customs legislation applicable - is increasingly difficult to determine.

1. European Commission, Taxation in the European Union.
2. *Ibidem.*, p. 8.

Whether it is product design, component manufacturing, assembly or marketing, companies operate the world over, thereby creating international production lines. Pascal Lamy summed up the new reality in a speech made at the French Senate on 15 October 2010, stating: "*more and more products are Made in the World*". The digital revolution accelerates the impact of globalisation. It facilitates the geographical dispersion of production processes and makes it increasingly difficult to link added value production to a territory.

Faced with such economic "deterritorialisation", EU Member State tax laws are circumvented by multinational companies, particularly the GAFAM (GOOGLE, APPLE, FACEBOOK, AMAZON, MICROSOFT).

Two figures underscore the disconnect between a company's business location and its profit. As it stands, according to the statistics of the US Bureau of Economic Analysis, nearly 60% of the profits made by American multinationals outside the United States (US) are declared in low-tax countries, notably Ireland and Bermuda. 95% of the 17 million employees employed by multinationals outside the US work in relatively high tax jurisdictions, specifically Canada, Mexico, the United Kingdom (UK) and China.[3].

1.2.2. RENEWED DEBATE ON HARMFUL TAX COMPETITION

The 2008 financial crisis, followed by the economic crisis, revived the debate on the legitimacy of aid to countries that practice aggressive tax competition. Against the background of a public finance crisis and the establishment of intra-European financial solidarity, debate has centred on one question: should European aid compensate for revenue losses resulting from tax attractiveness policies or government dysfunction? Three types of country were the focus of the debate from different standpoints:

- Ireland has benefited from substantial structural funds, which have offset revenue losses resulting from its tax attractiveness policy in corporate tax.
- The 10 new Member States which aggressively compete on tax and social security in an effort to catch up in economic terms with older EU Member States.
- Greece, whose tax policy and administration contributed to the budget deficit and debt, requiring the need for European solidarity.

The debates did not result in the establishment of specific conditions. Regarding New Member States, several studies have pointed out that amounts of structural funding received are not comparable with tax revenue levels. According to a focus review conducted by BNP Paribas' Economic Research Department *"between 2004 and 2006, structural fund net transfers to the 10 new EU members totalled €23 billion (approx. half went to Poland). This accounted for only 2% of the 10 new Member States' total tax revenue (4-8% for the Baltic States)*[4]*"*.

3. "*Le triomphe de l'injustice : richesse, évasion fiscale et démocratie*" ("The triumph of injustice") by Gabriel Zucman and Emmanuel Saez, Seuil, 2020.
4. "*UE :Concurrence ou harmonisation fiscale* ?" ("EU: Competition or tax harmonisation?"), a review by Raymond van der Putten and Eric Vergnaud, BNP Paribas Economic Research Department, 2007.

1.3. IMPACT DIFFICULT TO ASSESS

1.3.1. TAX REVENUE LOSSES ARE DIFFICULT TO ASSESS

It is virtually impossible to accurately assess the loss of Member State tax revenue due to harmful tax competition. They result from the use of legal tax avoidance techniques, but also illegal fraud. The European Parliament (EP) noted "*that several assessments have attempted to quantify the magnitude of losses from tax fraud, tax evasion and aggressive tax planning; recalls that none of these provide a large enough picture on their own due to the nature of the data or the lack thereof*"[5]. These different assessments often relate to different bases and are not comparable.

Some assessments have been made on a global scale. AnInternational Monetary Fund (IMF) working paper[6] estimates profit transfers to tax havens at c.€550 billion each year, representing more than one-third of the profits generated by multinational foreign subsidiaries. 47% of the €550 billion is transferred to Luxembourg, Ireland, the Netherlands, Belgium, Cyprus and Malta. The study estimates the transfers are responsible for a loss of €14 billion in revenue.

Professor Richard Murphy, a tax specialist based at City University, London, published a new study on 23 January 2019. The study, which was commissioned by the Group of the Progressive Alliance of Socialists & Democrats in the European Parliament, estimates that in 2015, tax evasion, including tax fraud, accounted for between €750 and €900 billion in lost revenue for EU Member States. This included €190 billion for Italy and almost €120 billion for France.

1.3.2. PENALTIES FOR EUROPEAN COMPANIES

European company penalties are twofold. The first favours foreign firms selling in the internal market that benefit from preferential arrangements to the detriment of firms in the Member States. They can pay up to 30% less tax than their domestic competitors.

The second favours other European companies to the detriment of those of Member States that do not practice unfair competition. Such competition between European companies adversely affects the single market.

5. European Parliament Report on "financial crimes, tax evasion and tax avoidance" by Jeppe Kofod and Luděk Niedermayer, 8 March 2019.
6. "*The missing profits of nations*" by Thomas Torslov, Ludwig Wier and Gabriel Zucman, National Bureau of Economic Research, working paper no. 24701, 2018.

2. INCREASINGLY DIVERSE MEASURES USED IN HARMFUL TAX COMPETITION

2.1. PROLIFERATION OF HARMFUL REGIMES AND PRACTICES

2.1.1. HARMFUL TAX REGIME REVIEW BY PRIMAROLO GROUP

Identifying harmful EU tax regimes is a challenge. The Member States that use such practices are also discrete about them. This explains why following an informal Ecofin Council meeting in Verona on 9 March 1998, a "Code of Conduct" group was created (business taxation). The group was led by Ms. Dawn Primarolo, UK Paymaster General and tasked with assessing tax measures that may fall within the scope of the Code of Conduct for Business Taxation.

After studying 271 potentially harmful tax regimes selected by the EC, this group identified **66 harmful tax measures** (40 in EU Member States, 3 in Gibraltar and 23 in dependent or associated territories). The group's report, published in 1999, noted that five countries had 51 of the 66 tax regimes considered "harmful": ***Belgium, Ireland, Luxembourg, the UK and the Netherlands.***

2.1.2. BUSINESS TAX BASE EROSION PRACTICES

The first technique for eroding tax bases consists in leveraging intra-group transactions to locate the maximum deductible expenses in a high-tax country to reduce or even eliminate profits subject to corporate tax.

Transactions may involve products, services or tangible and intangible assets. Such transactions go unnoticed in markets. They are conducted between companies within the same group. It is difficult to challenge the transfer prices charged despite the emergence of common methods (arm's length principle). Who can claim legitimacy in pricing a brand or a logo, for instance?

Brand fees reduce the profits of subsidiaries located in high-tax states, thereby maximising the profit of a company paid and located in a low-tax state. The technique is widely used in digital and retail sectors. McDonald's and Starbucks are cases in point[7]. Nonetheless, transactions may also focus on management services or the sale of algorithms.

The second tax base erosion technique concerns corporate debt. Since the interest on loans is generally deductible from corporate tax, a group's strategy will be to have companies located in high-tax countries assume debt for the parent company located in a low-tax country. In doing so, profits are maximised.

The third tax base erosion technique involves the scope of consolidation of groups. It involves changing the role of the companies that make up the groups to benefit from the national

7. "*Un impôt juste, c'est possible !*" ("Fair taxes are possible!") by Pierre-Alain Muet, Seuil, 2018.

tax systems of the group's Member State locations. This technique is used by ARCELOR MITTAL, for example. The outcome: companies that make products may be transformed into mere agent companies.

2.2. DEBATE ON THE REALITY OF EUROPEAN TAX HAVENS

2.2.1. FROM THE OECD'S LIST OF DEFINITIONS

Tax havens first appeared in the US in the nineteenth century. They are territories where taxes are levied at a lower rate than other countries. The "tax haven" phenomenon is nothing new. The use of the term appeared as early as the Middle Ages, designating cities housing the merchant shipping ports between Hanseatic cities. The latter gradually acquired many privileges, especially relating to taxation.

Tax havens are used mainly by speculative funds and large corporations. Tax havens are used as a base for subsidiaries (Google has one in Bermuda, for example) and wealthy private individuals.

- The appeal is to benefit from avoiding higher taxation in the country of origin. The phenomenon is widespread in France. In April 2009, following the HSBC tax scandal, France set up a "regularisation unit" dedicated to tax fraud. The unit repatriated €7.3 billion in assets, with tax profits totalling €1.3 billion.
- Moreover, tax havens harbour an unquantifiable share of assets for laundering dirty money from corruption or drug trafficking.

The IMF estimates that 50% of global transactions pass through tax havens. The latter are home to 4,000 banks, two-thirds of hedge funds and two million shell companies. Approximately $7,000 billion in assets are dormant in these accounts, i.e. more than three times French GDP. Gabriel Zucman, a Professor of Economics at UC Berkeley, estimates that the amount of individual assets held in tax havens amounts to 8% of the world's financial resources.

Going beyond the volume of assets reviewed, the lack of transparency in these so-called "offshore" financial centres distorts economic analyses (e.g. of the financial health of a company, for example) as well as the competition rules between governments.

The OECD identified 35 tax haven territories in June 2000. Many of them depend on EU countries, including: Netherlands Antilles and Aruba (the Netherlands), the British Virgin Islands and Channel Islands – Jersey, Guernsey, Sark and Alderney – the Isle of Man, Gibraltar (United Kingdom), Andorra (France-Spain), Monaco (France) and Liechtenstein. The Netherlands and the UK are therefore doubly guilty.

2.2.2. AN EMERGING PAN-EUROPEAN TAX HAVEN STRATEGY

In June 2015, the EC drew up an initial Pan-European list of tax havens. The EU has adopted a series of measures aimed at combating tax avoidance, evasion or planning practices.

- The Economic and Financial Affairs Council (Ecofin) then focused on the initiative. A "Code of Conduct" group of national experts was then formed, following the creation of an initial group in 1998 (Primarolo, see section 3.2.1).
- Overall, 216 countries and territories were identified. Approximately 90 that threatened European countries from a taxation standpoint were investigated in depth. A common list of tax havens was drawn up using the surveys and exchanges between the Eurogroup working group and the territories' tax administrations.
- Since the list update on 18 February 2020, 12 territories feature on the European list of "non-cooperative tax jurisdictions" (black list):

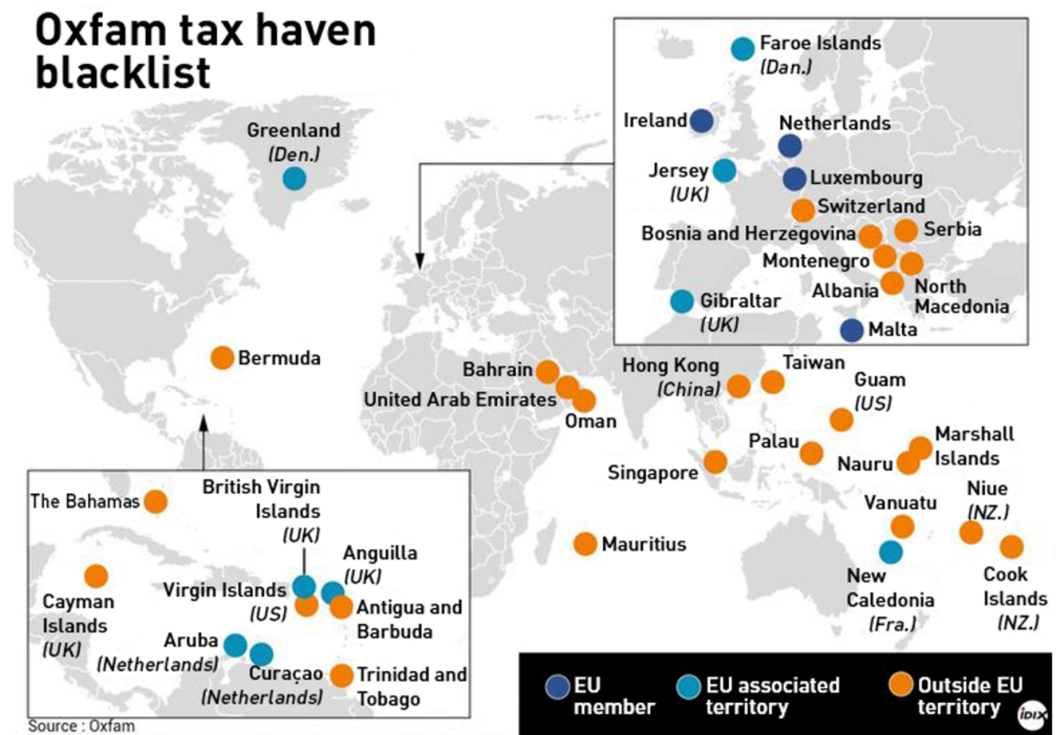
    - Fiji (Oceania);
    - Guam (Oceania, US territory);
    - **Cayman Islands** (Caribbean, UK territory);
    - US Virgin Islands (Caribbean, US territory);
    - Oman (Arabian Peninsula);
    - **Palau** (Oceania);
    - Panama (Central America);
    - Samoa (Oceania);
    - American Samoa (Oceania, US territory);
    - **Seychelles** (Indian Ocean);
    - Trinidad and Tobago (Caribbean);
    - Vanuatu (Oceania).

The EC claims the listed countries refused to enter discussions with the EU or address their shortcomings as regards proper tax governance.

2.2.3. LISTS CHALLENGED BY SOME NGOs

NGOs still challenged the official lists identifying tax havens. The *Tax Justice Network* (TJN) criticised the OECD's classification, judging it as weak with inadequate requirements. On the basis of an index that combines the level of fuzziness with the weight of the various global economy financial centres, TJN estimates that the 10 main tax havens are as follows, in order of importance: the State of Delaware in the US, **Luxembourg**, Switzerland, Cayman Islands, the City of London, **Ireland**, Bermuda, Singapore, **Belgium** and Hong Kong. Oxfam followed TJN's example, publishing its own list (see map below). Oxfam's list also includes several EU Member States.

FIGURE 2 ▪ Oxfam tax haven blacklist



Source: Boursorama

The European Parliament was also a critic of the list established by the European Commission. On 1 March 2018, the Parliament set up a committee of inquiry, known as Tax III. Its report, published on 26 March 2019, found that some Member States showcase tax haven features. States included: Belgium, Cyprus, Hungary, irlande, Luxembourg, Malta and the Netherlands.

2.3. HARMFUL TAX COMPETITION AND THINKING OUTSIDE THE BOX

2.3.1. FIGHTING FRAUD REQUIRES CREATIVITY

Fraud also constitutes harmful practice from a competition standpoint. Companies practicing fraud benefit from massive and illegal competitive advantages.

The EC is particularly concerned about VAT fraud — a harmonised tax with threshold rules for its rates — because of its scale. Its latest VAT gap report, published in September 2019, estimates total EU VAT loss in 2017 of **€137.5 billion, i.e. a loss of 11.2% of total expected VAT receipts.**

The VAT gap, which is the difference between expected VAT receipts and VAT actually collected, provides an estimate of revenue losses resulting from tax evasion. As a metric, it includes fraud as well as bankruptcy, insolvency and miscalculation.

VAT is subject to organised fraud such as carousel fraud (see text box below).

BOX 2 ▪ Carousel fraud

When goods and services cross borders, it opens up opportunities for VAT exemption fraud for intra-Community supplies.

The EC calculates that cross-border fraud accounts for one-third of all EU VAT fraud (€50 of the €150 billion in VAT lost each year). According to the European Court of Auditors (ECA) and Europol, 2% of organised crime groups commit up to 80% of cross-border fraud. While it delivers high returns rapidly, cross-border fraud is a high stakes game. More often than not, organised crime groups use the money earned from fraud to finance illegal activities.

One of the most frequent frauds is the so-called "Missing trader" technique. Take, for instance, a supplier based in Germany supplying VAT-exempt goods to a company (the "missing trader") in France. The missing trader collects VAT on the resale of the goods without paying it back to the Member State's government before suddenly disappearing. Acting in good faith, the company that paid the VAT may deduct it. The "carousel" technique refers to multiple occurrences of the "missing trader" technique.

Source: Cour des comptes, French Supreme Audit Institution La fraude aux prélèvements obligatoires (Tax Levy Fraud), November 2019.

2.3.2. POLICIES TO ATTRACT COMPANY HQs

Several European countries deliberately practice policies to attract company headquarters (HQs). This type of practice constitutes unfair competition. Rather than immediate impact, the real issue lies with the indirect effects of relocation. Generally speaking, HQ relocation creates few jobs. Nevertheless, it does influence a company's legal organisation as well as some of its decisions, which may benefit the HQ host country. Above all, though, HQ relocation has the potential to enhance a Member State's image, thereby boosting its attractiveness to foreign investors. To this end, Belgium, Luxembourg and the Netherlands use taxation to persuade companies to set up their HQ in their countries.

FIGURE 3 ▪ A welcoming land for CAC40 stars and other large corporations

Source : Archives, Les Échos

One example of this is Luxembourg, which benefits from a tax ruling, making it possible for the country to "tailor its tax offer to companies' specific needs". The tax ruling is a written interpretation of tax rules applied to a factual situation that is legally binding on the original tax authority. AMAZON and its subsidiary, AMAZON EU, based in Luxembourg, benefited from such a ruling, evading corporate tax for eight years (between 2006 and 2014). The EC then sentenced the multinational to pay back €250 million of illegal government tax aid to the Luxembourg government.

As our attached map suggests, the Netherlands is currently and probably the most attractive country for HQ and holding relocation. Holding companies benefit from a special tax regime offering an array of tax incentives for their shareholders among others. From the standpoint of European tax law, this legal practice influences (re)location decisions for many holding companies. As such, it generates tax revenue losses for other EU Member States. Within the context of this note, it may be described as a harmful tax practice.

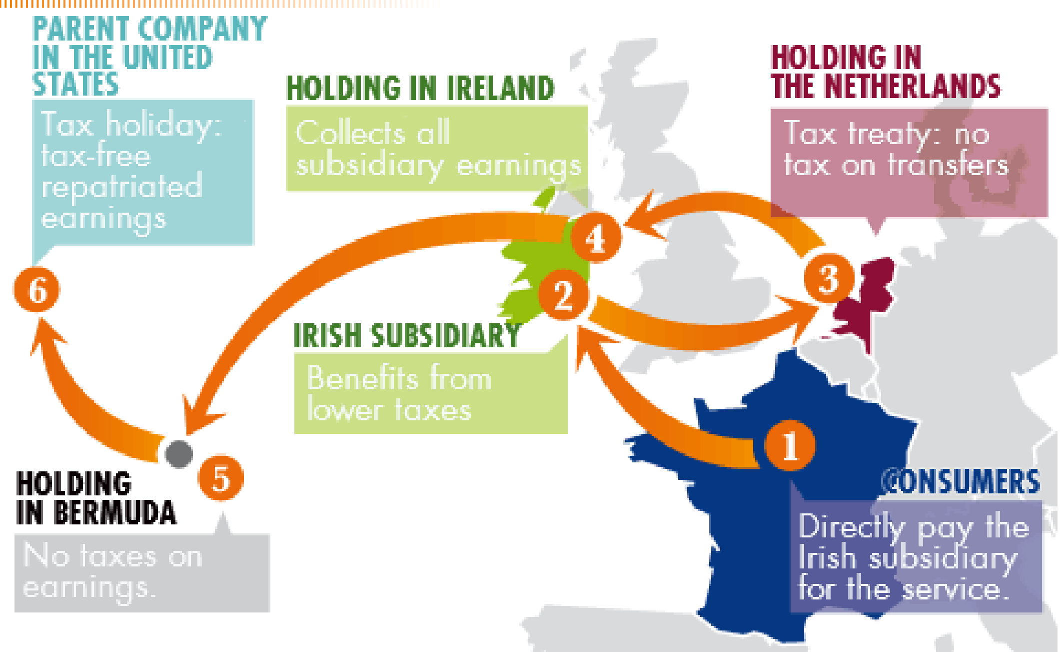
2.3.3. OVERLAPPING TECHNIQUES: THE DOUBLE IRISH WITH A DUTCH SANDWICH

The tax schemes nicknamed "double Irish" and "Dutch sandwich" combine and sequence optimisation techniques using loopholes in national legislation and tax treaties as well as the taxation offered by tax havens.

The Irish sandwich involves a minimum of three companies and three different countries (the Netherlands, Ireland and Bermuda).

It is a complex scheme (see infographic below) combining the advantages offered by different regulations in several countries. Its sole aim: avoiding tax levies on profits. Much was said about the tax optimisation strategy in the media as it drew criticism from the world over. Google was the first group to confirm that as of 1 January 2020, it will no longer benefit from the "double Irish" or the "Dutch sandwich". In recent years, the EU has developed new measures to combat harmful tax competition in collaboration with other international forums and organisations such as G7 and the OECD.

FIGURE 4 ▪ The double Irish with a Dutch sandwich



Source : Frenchweb.fr

3 ▪ ATTEMPTS TO COMBAT HARMFUL TAX COMPETITION

3.1. USING TAX HARMONISATION TO TACKLE HARMFUL COMPETITION

3.1.1. HARMONISATION: A TOOL TO PREVENT HARMFUL COMPETITION

Tax harmonisation can be used as a tool to prevent harmful tax competition. Member States would no longer be able to implement policies that make their tax systems more attractive. The common external tariff in customs law is an excellent case in point.

From the outset, the Treaty of Rome provided for the prohibition of restrictions on indirect taxes (prohibition of taxes having equivalent effect to customs duties[8] and discriminatory[9] or protective internal taxes) and the approximation of tax legislation[10]in this area. As an example, article 99, paragraph 1, of the Treaty of Rome signed 25 March 1957, stipulates that "*The Commission shall consider how the legislation of the various Member States concerning turnover taxes, excise duties and other forms of indirect taxation, including countervailing measures applicable to trade between Member States, can be harmonised in the interest of the common market*".

Indirect tax harmonisation has restricted unfair practices, but they have not been completely eradicated. When harmonisation is made up of minimum requirements for tax rates, it restricts harmful competition without completely eradicating it. This especially applies to alcohol and cigarettes.

Conversely, rulings on direct taxation have been left to the European courts regarding the conditions for reconciling the development of the internal market and the fiscal sovereignty of Member States, in the absence of legal EU provisions and given the EU's lack of sovereignty on tax matters. In its *Schumacker* judgement, the Court of Justice of the European Union (CJEU) ruled that *"direct taxation does not as such fall within the purview of the Union, the powers retained by the Member States must nevertheless be exercised consistently with EU law"*[11]. Even in a largely non-harmonised area such as direct taxation, Member States are obliged to respect the treaties and the EU's secondary legislation.

Some aspects of direct taxation have nevertheless been applied to attempt to draw the broad lines of a harmonised system.

By adopting the "Merger" directive (revised in 2009) and the "Parent-Subsidiary" directive in 1990 (revised in 2003), the EU attempted to remove tax obstacles to the proper functioning of the single market. In its efforts, the EU sought to reduce measures that were not conducive to regrouping and restructuring companies from different Member States as well as eliminating double taxation on profits. Directive 2009/133 of 19 October 2009, on "mergers" established *"a common system of taxation under which any capital gain on*

8. See Art. 30 TFEU.
9. See Art. 110 TFEU.
10. Approximation of laws governed by Art. 115 TFEU.
11. CJEU, 1995, *Schumacker, case* C-279/93.

a merger, demerger, transfer of assets or exchange of shares is not taxed at the time of the transaction, but only when that gain is actually realised"[12]. The directive aims to ensure effective free movement of capital. At the same time, however, the directive reserved a clause for Member States that may refuse to apply the provisions where the main purpose of the merger, demerger, division of assets or exchange of shares is tax fraud or evasion.

Such embryonic harmonisation has not stopped some countries developing harmful direct taxation practices, particularly in the area of corporate taxation.

3.1.2. INITIATIVES TO HARMONISE CORPORATE TAXATION

Harmful corporate tax competition is two-pronged. It may focus on tax bases or tax rates. The EC was concerned with preparing for such competition as early as 1962, when the Neumark report was published. Since, a number of reports have suggested approximating tax rates within a range without the need for major legislative change.

The 2008 financial crisis and its resulting public deficits revived the need to focus on combating tax revenue losses. Ultimately, this drove a desire to implement corporate tax convergence across the EU. In 2011, the EC started to develop a model to harmonise the corporate tax base, but discussions fizzled out.

The February 2013 report entitled *Addressing Base Erosion and Profit Shifting*[13], resulted in the OECD and G20 countries adopting an Action Plan in September 2013. The plan is made up of 15 actions to counter harmful practices. The EC implemented a series of measures to promote the development of a common consolidated corporate tax base for the largest global corporations.

The measures, which were presented on 26 October 2016, include two directives (CCTB and CCCTB). Both establish common rules to calculate the corporate income tax base together with rules for profit allocation within a group. Despite a common Franco-German stance on the proposals, to date there has been no formal agreement.

The same scenario applies to the March 2018 proposal for a European digital tax. The EC's initiative, which required approval across the board, failed due to the opposition of certain Member States. As a result, in 2019, France introduced a Digital Services Tax[14] (DST), which provided transition pending agreement between EU Member States and even the OECD.

3.2. ATTEMPTS TO ERADICATE HARMFUL TAX PRACTICES

3.2.1. CODE OF CONDUCT AND ELIMINATION OF HARMFUL TAX REGIMES

In 1997, the ECOFIN Council adopted a Code of Conduct for business taxation. The Code stipulates that "*the Member States agreed to eliminate existing taxation measures that consti-*

12. https://ue.delegfrance.org/fiscalite-2029.
13. Base Erosion and Profit Shifting (BEPS).
14. Art. 299 et seq. French General Tax Code.

tute harmful tax competition [and] refrain from introducing any such new measures in the future". Moreover, in 2009, the EC pointed out that there is a "*political agreement between Member States to combat harmful tax competition in corporate tax*".

The adoption of this code was followed by the establishment of the PRIMAROLO group. In 1999, this group identified harmful tax regimes to be eliminated as a matter of priority. At the end of November 2000, the European Finance Ministers then adopted a timetable for rollback with a deadline set for 2005. Hereafter, only derogations were granted on a case-by-case basis. Member States not complying with the Code of Conduct could be referred to the European Court of Justice. In 2006, Luxembourg was taken to court for upholding a discriminatory measure against foreign countries known as "the Holding 1929 regime".

Essentially, then, this elimination phase proved successful. However, this does not detract from the creativity used in harmful tax competition. It requires constant monitoring.

3.2.2. NEW EC INITIATIVES TO TACKLE TAX EVASION

In light of the obstacles limiting the scope to harmonise direct taxation and further develop the Code of Conduct, the EU has prioritised tax policy coordination, administrative cooperation and tax transparency. As part of its programme to combat corporate tax evasion and harmful tax competition, it complemented the initiatives started in 2011, with a series of measures presented in March 2015. To supplement founding Council Directive no. 2011/16/EU of 15 February 2011, on administrative cooperation in taxation, the EU has launched an automatic exchange of information in tax matters between national administrations. This initiative is part of the OECD's work on exchanges of information.

In this context, Member States have adopted a series of legislative acts aimed at:

- **boosting tax transparency: five directives** amending the 2011 Directive have successfully developed an automatic exchange of information between EU tax administrations;
- **fighting tax abuse through two anti-tax-avoidance directives (ATADs).** The **ATAD 1 directive** of 12 July 2016 reprised measures from the OECD's BEPS plan allowing taxation, in an EU country serving as the location of a multinational company's HQ, of profits lodged in tax havens. The **ATAD 2 Directive** of 29 May 2017, supported the ATAD 1 Directive regarding rules aimed at **neutralising the tax advantage of the use of hybrid arrangements.**

3.3. INCREASED RANGE OF COUNTER INITIATIVES

3.3.1. A NEW APPROACH FOCUSED ON DISTORSION OF COMPETITION

Under the leadership of Margrethe Vestager, the EU Commissioner for Competition Policy, a new approach has been developed to counter harmful tax competition. It focuses on ensuring minimal distortion of competition. The Directorate-General (DG) for Competition has initiated a large number of investigations into all tax practices, resulting in distortion of competition. In doing so, the DG has severely sanctioned Member States that use such practices.

At the same time, and at the initiative of several Member States, including France, the EC presented legislative proposals on financial transactions and digital taxation. Agreements have not yet been reached on these subjects.

3.3.2. USE OF STATE AID LAW

Drawing on the case law of its International Criminal Tribunal (TPICE)[15](now the EU Tribunal), **the EC has been using State aid law since the early 2000s to combat harmful tax competition between Member States.** The courts of the European Union have settled the debates on the possibility of using articles 107 to 109 of the TFEU in tax matters: "*there is no reason why a specific matter such as taxation should escape the general prohibition of unauthorised State aid as long as no specific derogation is provided for it*".[16].

The EC conducted an audit of "selective" tax benefits under article 107 of the TFEU. On the basis of TFEU article 108, the EC reviews, in accordance with the case law of the Court of Justice of the European Union (CJEU), the compatibility of existing and new aid with the proper functioning of the internal market. With regard to tax-related State aid, the EU courts (Tribunal and CJEU) assess the selectivity of the measure. A tax measure is classified as selective, constituting State aid, if it cannot benefit all economic operators. Even though all operators are in a comparable situation, the aid only benefits one of them.[17] Practically speaking, the courts will "*compare the beneficiary's situation resulting from the application of the relevant measure with that of the beneficiary in the absence of the measure in question and in application of the normal rules of taxation*"[18].

Commissioner Vestager may be singled out for her efforts to curb tax evasion through the rules of competition policy. However, EC policy is partly undermined by some of the EU Tribunal's rulings[19]. On top of this, there are the pending decisions made by the CJEU. They require the EC to provide a high level of evidence in order to establish the selectivity of the tax advantage.

In the *Apple* case, the EC decided that by granting *rulings* to the company without prior approval, the Irish tax authorities had granted unlawful State aid which had to be recovered.[20] Nevertheless**, the EU Tribunal's ruling** of 15 July 2020, **annulled the contested decision since the EC failed to sufficiently demonstrate the existence of an advantage under article 107, paragraph 1, TFEU"**. The Tribunal stipulated that **"the EC erroneously declared the existence of a selective economic advantage, and accordingly, of State aid**" to the benefit of Apple subsidiaries.

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15. TPICE, 27 January 1998, *Ladbroke Racing c/ Commission,* case T-67/94 : "*while it is true that taxation and the establishment of national tax systems fall within the competence of the national authorities, the exercise of such competence may, where appropriate, prove incompatible with article (107) 1st par. in the Treaty*".
16. Maitrot De La Motte (A), "*Les enjeux de l'affaire Apple après l'arrêt du Tribunal de l'Union européenne du 15 juillet 2020*", ("The challenges of the Apple case following The EU Tribunal's ruling of 15 July 2020". Revue de droit fiscal, no. 30-35, 23 July 2020, p. 320.
17. CJEC, 8 Nov. 2000, Adria-Wien Pipeline, case C-143/99.
18. EU Trib., 24 September, 2019, Starbucks Corp. case T-636/16.
19. In the ruling on Starbucks Corp. & Starbucks Manufacturing EMEA BV, the EU Tribunal upheld the view that the EC had failed to establish that the agreement signed between the Netherlands tax authorities and Starbucks conferred the company an economic advantage. The latter directly impacts free and undistorted competition.
20. See European Commission, press release no. IP/16/2923 of 30 August 2016, regarding its decision SA 38373.

However, definitive conclusions should not be drawn before litigation has ended. The Tribunal added that it "*endorses the EC's assessments of normal taxation under Irish tax law applicable in this case, particularly regarding the tools developed within the Organisation for Economic Cooperation and Development (OECD), such as the arm's length principle, to verify whether the level of taxable profits validated by the Irish authorities corresponds to that which would have been obtained under market conditions*".

3.3.3. USE OF COORDINATED ECONOMIC POLICIES (EUROPEAN SEMESTER)

The incorporation of practices to counter harmful competition into the European Semester procedure is underway. Using the EC's report, it sets out a peer review of national economic policies. Every national reform programme must present the taxation regimes likely to create distortion of competition, submitting them for EC and peer reviews. Seven Member States received recommendations. However, generally speaking, the peer review method is not very effective in a European context. Government representatives are cautious in their assessments because of concern for their government being scrutinised on other matters in return. Any attempt to use the procedure in the European Semester to combat harmful competition should be reviewed and fine-tuned if it is to be effective.

4 ▪ POTENTIAL FUTURE SOLUTIONS

4.1. SHORT AND MEDIUM-TERM FISCAL UTOPIAS

4.1.1. TFEU'S PLANNED CHANGES TO DECISION-MAKING

There are two main reasons behind the rigidity of European tax law, which blocks any legislative development. First, the monopoly of the EC's legislative initiative. The latter requires the EC to be fully convinced before putting a tax law on the negotiating table. Second, the unanimity rule applicable to tax decisions within the Council, which grants a veto power to each Member State.

It is tempting to recommend amending treaties even if it is just to "break the deadlock" of unanimity. However, this option appears unrealistic in the short and medium term despite the completion of Brexit for the UK, which attaches great importance to its fiscal sovereignty. It requires a unanimous agreement by all Member States, which seems unlikely given the current circumstances. Even if this option were to materialise, it is not certain that practitioners of unfair tax competition would not succeed in blocking majorities.

Mindful of the circumstances, in January 2019, the EC proposed a four stage roadmap[21] to ensure specified majority voting in the Council without amending the treaties and by agreeing

21. European Commission, *Communication from the Commission to the European Parliament, the European Council and the Council, Towards a more efficient and democratic decision making in EU tax policy [COM (2019) 8 final]*, 15 January 2019.

on the arrangements for implementing its provisions. The first two stages are set to be rolled out quickly while the last two will be ready by end-2025[22].

- The first stage involves transitioning to a decision-making process based on specified majority voting for measures to **counter abusive tax practices;**
- The second stage would introduce specified majority voting, accelerating measures where **taxation supports other policy objectives,** such as the fight against climate change;
- The third stage creates the conditions for specified majority voting to **modernise already harmonised EU rules;**
- Lastly, the fourth stage aims to use specified majority voting for **large-scale taxation initiatives.** This factors in the common consolidated corporate tax base (CCCTB) and a new taxation system for the digital economy.

Several large EU countries have welcomed the idea of a gradual transition. Conversely, Nordic and Eastern European countries along with Ireland and Portugal have opposed the planned roadmap. This route seems permanently closed; or at least in the short to medium-term. It very much remains an utopian idea.

4.1.2. FISCAL UTOPIAS THE WORLD OVER

Other proposals, this time on a global scale, are even more of a fiscal utopia. This is because they do not offer a credible solution to combating harmful tax competition in the short and medium term.

The idea of a wide-scale financial and taxation COP meeting was first put forward in the book, "*Sans Domicile Fisc*" ("No tax residence")[23]. The idea has since been further discussed by several public figures including the French member of parliament, Alain Bocquet. A draft European resolution was proposed on 21 December 2016, adopting the 16 December 2016 recommendations of the French Economic, Social and Environmental Council (ESEC): "*Following the example of the environmental COP, which since 1992 (Rio Conference) has made it possible to engage in a discussion with all global States on global warming issues and adopt a number of measures, the ESEC recommends the organisation of a conference of States on countering tax avoidance*".

Economists have also put forward global-scale measures. For instance, Thomas Piketty has suggested a supranational wealth tax and corporate tax system. On the other hand, Gabriel Zucman has shown more concern for States maintaining their fiscal sovereignty by creating global financial cadastral values. This would mean States have all the information they need in the fight against tax evasion. Such measures, which are against the sovereignty of States on the one hand and the financial interests of several countries (including tax havens) on the other, appear to lack credibility in the short and medium term.

22. Information report for the French National Assembly on the European fiscal space, Xavier Paluskiewicz and Frédérique Dumas, July 2020.
23. Appeared in the September 2016 collection of the Cherche Midi publishing house.

4.2. LEVERAGING THE FLEXIBILITY OF TREATIES

4.2.1. INADEQUACY OF THE ENHANCED COOPERATION PROCEDURE

In the event of failure to obtain unanimous agreement between the Member States, the treaties may use the **enhanced cooperation**[24] procedure. It must be approved by a group of at least nine Member States, on the basis of a Commission proposal covering areas within the framework of a treaty. The enhanced cooperation procedure may only be used within the framework of the EU's non-exclusive competences. It must also respect the competences, rights and obligations of non-participating Member States. Lastly, such cooperation must not affect the internal market or economic, social and territorial cohesion. It must also not create a distortion of competition between Member States.

As things stand, though, the only attempt to use this procedure in tax matters, the Financial Transaction Tax, has failed.

4.2.2. USE OF THE TREATIES' PASSERELLE CLAUSES

By unanimous agreement, a *passerelle* clause changes the voting rule in the Council from unanimity to specified majority voting. The Treaties provide for two such clauses: one **general** (article 48 of the Treaty on the Functioning of the European Union), the other specific for **environmental** measures (article 192 of the Treaty on the Functioning of the European Union).

The general clause is a red herring since it is based on a complex procedure initiated by the European Council, granting a veto power to each of the national parliaments.

On the contrary, the article 192 procedure (specific clause) does not offer such a stumbling block. As an initiative created by the EC, this particular procedure validates approval of a passerelle clause to make "*essentially tax-related provisions*" with a view to achieving subsequent environmental objectives.

The EC is advised to explore the possibilities of using this specific procedure, as it did so at the end of the previous parliamentary term[25].

4.3. A SOLUTION WORTH PURSUING: USING COMPETITION RULES

4.3.1. USING TFEU's ARTICLE 116 ON DISTORTION OF COMPETITION

TFEU's new article 116 has never been used before. In accordance with the ordinary legislative procedure, it adopts directives to **eliminate distortions of competition** through existing disparities between Member States' rules if the distortion cannot be removed through consultation with the Member States.

24. Art. 20 TEU and art. 326-334 TFEU.
25. O.Marty, Institut Jacques Delors, 2019, *Fiscalité : l'unanimité à dépasser ("Taxation: overcoming unanimity")*, 25 February 2019

From a legal standpoint, article 116 is fuzzy. However, it does not expressly rule out taxation. There is scope for application since taxation significantly impacts the functioning of the internal market. And yet, despite repeated requests from the European Parliament, **the EC has so far considered this procedure unclear and difficult to implement.**

This position should be reviewed. If necessary, the CJEU should specifically outline the conditions for using this procedure.

4.3.2. DEVELOPING A SOLUTION BASED ON DISTORTION OF COMPETITION

This approach is most in line with European interests and should be developed provided it does not require unanimous decisions. As a solution, it is pivotal for two reasons. First, harmful tax practices conceal breaches of solidarity between Member States. Second, such practices mask major distortions of competition between companies operating within the internal market.

Several solutions are worth exploring:

- The EC's annual report on EU tax policies, which produces an analysis in the context of the European semester and supports the tax policy priorities of the EC's annual growth review. The 2020 report included a chapter dedicated to tax competition. **In this respect, incorporating practices to counter harmful competition into the European Semester procedure should be continued.**
- A review of obstacles to **using State aid rules,** based on the emerging related case law upon conclusion of the Apple case's legal proceedings.
- The development of **new research by the European Commission's Directorate General for Competition** on State tax aid. Moreover, the **drafting of a specific annual report** sent to the other institutions of the EC/EU institutional square.
- During the agreement review of its multiannual financial framework, its stimulus plan and decision-making on its own resources, the European Parliament should suggest political groups include a **conditionality. The latter should focus on rolling back the most harmful tax regimes and practices in order to benefit from the structural funds or rebates from budget financing contributions.**

The Council of Europe's conclusions from 21 July 2020, presenting the recovery plan addressing the effects of the Covid-19 crisis and the multi-annual financial framework adopted by heads of state and governments, underlines the challenges in terms of solidarity faced by EU Member States. In particular, it was noted that: *"While utmost vigilance is still required on the health situation, the focus is now shifting to mitigating the socio-economic damage. This requires an unprecedented effort and an innovative approach, fostering convergence, resilience and transformation in the European Union"*. The extraordinary spending involved to drive the Recovery effort and the risk of economic divergence within the Union require this "*unprecedented effort*" in terms of European solidarity, which includes the fight against harmful tax competition. This type of competition is not beneficial. On the contrary, it skews genuine competition between businesses, in particular between multinationals and other companies within the European internal market. In the new post-Covid-19 world, there is no place for harmful tax competition.

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CONCLUSION

The European Council's conclusions drafted 21 July, 2020, on the recovery plan to tackle the COVID-19 pandemic as well as the multiannual financial framework underscore the issue of solidarity. The latter is absolutely needed between EU Member States. More specifically, the conclusions stipulated that: "While utmost vigilance is still required on the sanitary situation, the emphasis is now shifting to mitigating the socio-economic damage. This requires an unprecedented effort and an innovative approach, fostering convergence, resilience and transformation in the European Union". The historic budgetary expenditure incurred by the recovery plan and the risk of diverging economies within the EU require such "unprecedented effort" to demonstrate European solidarity. This involves the fight against harmful tax competition. Such competition is not empowering. On the contrary, it distorts genuine competition between companies, specifically multinationals and other corporations within the EU internal market. If there is a "post-COVID world" in Europe, harmful tax competition is no longer a viable option.

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