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Tax Competition and EU Law

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When I agreed with Professor Peter Wattel, five years ago, to write my PhD thesis on tax competition in the European Union, I only had a vague idea of what this issue was all about. To my disappointment, research in literature and EU official documents was of little help. There was an abundance of US economic studies focusing on tax competition among US states. With regard to the EU, there was a chapter of the 1992 Ruding Report dealing with distortions to the common market created by the differences in Member States' direct tax systems and a few other Commission documents on the subject. However, I could not find any source clearly defining the concept of tax competition in an international context and setting out a methodology to evaluate its effects in the international arena. What was also missing was a comprehensive legal analysis of tax competition from an EU law perspective.

The situation is much different today. Several economic studies have been carried out on the effects of tax competition, also within the EU context. In almost every tax law journal, articles have been published on the EU and the OECD projects to deal with tax competition from an international and/or an EU perspective. Every other morning I find in my email inbox an update or breaking news on this subject. Where do all these developments leave this thesis? And how have they affected its contents and aims? In all honesty, I must answer that my original aims have not been affected much by these constant developments.

Specifically, the first aim of this research was to develop a clear concept of tax competition in an international context and a general theory yielding criteria to distinguish between beneficial and harmful tax competition. The next broad aim I had in mind was to analyse the relevant EU law provisions applicable to tax competition among Member States, or in other words what sovereignty limitations (general) EU law imposes on tax policy competition. By "EU law" I refer not only to legally binding provisions contained in the EC Treaty and in other EC acts such as directives, but also to non-legally binding acts such as resolutions, guidelines, notices, and the like, commonly known as 'soft law.' This analysis would be necessary to assess the appropriateness and effectiveness of the EU legal framework to deal with the harmful effects of tax competition in the EU and might reveal the need for a different approach to be adopted at EU level.

A last aim of this study was to analyse what remedies Member States had taken or were planning to take unilaterally to limit 'harmful' tax competition and the adverse effects of fellow States' tax measures on their tax revenue. The interesting issue from a research point of view was the relationship between Member States' domestic laws and relevant EU law, which, especially by way of the Treaty Freedoms, also imposes sovereignty limitations on the adoption and application of unilateral
countermeasures such as CFC legislation, denial of exemption for foreign dividends, denial of interest and/or royalty deductions (i.e. base erosion measures), and the like.

To serve the above aims, I used the following methodology in the different parts of this dissertation. Chapter 1 relies heavily on the US-focused economic literature on tax competition in order to develop a concise concept of tax competition in an international context and consequently to delineate the scope of this study. The analysis of such literature is also necessary to single out the effects brought about by tax competition, both its desirable and its harmful ones. This theoretical background is fundamental to better understand the documents and studies on tax competition within the EU, and in particular the most recent study released by the Commission in October 2001. The conclusions of this chapter influence the legal analysis of tax competition carried out throughout the rest of this book.

Chapters 2 through 5 specifically deal with the legal aspects of tax competition in the EU. Chapter 2 contains an analysis of the EC Treaty provisions potentially applicable to this phenomenon. A description of general EU law principles and provisions as interpreted by the European Court of Justice is necessary for an assessment of the effectiveness of the existing provisions to deal with (harmful) tax competition. Chapter 3 focuses on the application of the Treaty State aid rules to special tax incentives implemented by Member States and potentially constituting harmful tax competition. An analysis of the Commission investigations and of specific tax incentives previously or currently available in Member States' tax systems is carried out to assess whether the measures scrutinised are harmful, and whether these Treaty rules are sufficient and their remedies appropriate. Chapter 4 deals with EU 'soft law' specifically targeted at countering harmful tax competition, namely the Code of Conduct on Business Taxation and related documents. Once again, specific Member States' preferential tax regimes are assessed in the light of these documents to draw conclusions on their harmfulness and on the effectiveness of the EC measures. This Chapter also covers the OECD project against harmful tax competition, due to the close links with the Code of Conduct and the similarity of its nature, scope, and aims. The last part of the legal analysis, contained in Chapter 5, focuses on unilateral countermeasures adopted by Member States to protect themselves from other Member States' preferential tax measures considered 'harmful.' It is important to establish whether the current unilateral remedies are lawful from an EU law point of view, and if not how they should be amended to be compatible with EU law.

Chapter 6 offers a summary of the main findings and draws conclusions. Due to the shortcomings of the current EU legal framework, both 'hard' and 'soft' EU law, a proposal is set out for a comprehensive approach to deal with harmful tax competition in the EU. This proposal is explained by reference to a specific draft document that could be adopted for this purpose, so as to make it easier for the reader to understand its aim and reach.

In a nutshell, I have tried to assess tax competition in the EU from both an economic and a political, but especially a legal point of view. I am aware that there are still
several unresolved issues and a host of uncertainties surrounding the EU (as well as the OECD) project to counter harmful tax competition. I am also aware that my proposal would not do away with all such issues and uncertainty. However, I do hope that with this study I contributed to shed some light on the subject and it would make me happy if I raised further interest in it and perhaps further research on the issues addressed. Any comments, questions, criticisms on this book are very welcome and may be emailed to me at pintocar@yahoo.com.

For the completion of this book, I owe all my gratitude to Professor Peter Wattel. Not only did he constantly assist me with his invaluable academic input in an open and friendly way, carefully reading the drafts and providing me with his sharp and accurate feedback; he was also always available to solve any problem I encountered in my everyday life, and his warmth and accessibility at any time have extremely facilitated my task. My thanks are also due to my colleagues of Baker & McKenzie Amsterdam, who have always supported me both professionally and morally, and have made it easy to combine this effort with my professional practice of tax advisor. A last, greatest acknowledgement goes to my parents, Giovanna and Emilio, without whose unconditional love and care this book would have never been written. Thanks!

This book contains materials up to July 2002.